Canada. Royal commission on banking and finance.
Hearings, v. 34-36. Briefs, v. 28A-29A. 1962.

1964

7383
/

Royal Commission on Banking and Finance

LORD COBBOLD

Hearings held at
OTTAWA

Vol. 34

Date. 10 SEPT. 1962

Official Reporters
F.J. Nethercut and R.J. Young
Toronto, Ont.

Ottawa, Ontario
Monday,
September 10, 1962.

ROYAL COMMISSION ON BANKING
AND FINANCE

Hearings held at Ottawa, Ontario,
on Monday, September 10th,
1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer,
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W.A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H.A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

ROYAL COMMISSION ON BANKING
AND FINANCE

Hearings held at Ottawa, Ontario,
on Monday, September 10th,
1952.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer,
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W.A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H.A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

Ottawa, Ontario
Monday,
September 10, 1962.

---At 9:30 A.M. THE HEARING RESUMED

THE CHAIRMAN: We will now call the meeting to order.

This morning we have a submission from Lord Cobbold, formerly Governor of the Bank of England. I wish to welcome you this morning to the hearings of our Commission. We are very much indebted to you for coming to this country for this purpose especially and we look forward with great interest to a discussion, which no doubt will ensure, from the submission which you have placed before us.

Perhaps you would prefer at the outset to make a few remarks by way of introduction to the subject matter and, of course, our usual practice is to put questions to you on various phases of the subject and perhaps we may just as well proceed now. You may be seated, or you may stand, as you wish; these proceedings are very informal.

LORD COBBOLD: Thank you very much, Mr. Chairman and members of the Commission.

I take it as a great compliment that you have invited me to come here and appear before the Commission and I shall be only too anxious to give you any assistance that is in my power.

If I might make one or two general observations before we get down to the business of the morning, I would like just to recall to you, sir,

Ottawa, Ontario

September 10, 1959

---At 9:30 a.m. the meeting opened.

THE CHAIRMAN: We will now call the meeting to order.

This morning we have a submission from Lord Cobbold, formerly Governor of the Bank of England. I wish to welcome you this morning to the hearings of our Commission. We are very much indebted to you for coming to this country for this purpose especially and we look forward with great interest to a discussion, which no doubt will ensure, from the submission which you have placed before us.

Perhaps you would prefer at the outset to make a few remarks by way of introduction to the subject matter and, of course, our usual practice is to put questions to you on various phases of the subject and perhaps we may just as well proceed now. You may be seated, or you may stand, as you wish; these proceedings are very informal.

LORD COBBOLD: Thank you very much, Mr. Chairman and members of the Commission.

I take it as a great compliment that you have invited me to come here and appear before the Commission and I shall be only too anxious to give you any assistance that is in my power.

If I might make one or two general observations before we get down to the business of the morning, I would like just to recall to you, sir,

that I have been out of this trade for more than a year, and am therefore rather rusty on the subject, and you will forgive me if I am not quite up to date in any comments on current affairs, because honestly since the end of June of last year I have not been following these matters as closely as I did in the preceding 20 or 25 years.

Secondly, I would just like to emphasize that I shall be speaking throughout with reference to the Bank of England and to United Kingdom market, and although I have been fortunate enough to enjoy very close contacts with the Bank of Canada for 25 years or so, and have thus followed the Canadian scene from a distance, I lay no claim to intimate knowledge of Canadian banking or financial markets; I should therefore not presume to offer advice , comment or criticism on Canadian affairs. I would therefore ask the Commission to remember that in anything I say on the technical subjects I shall be speaking from the London angle in terms of United Kingdom conditions, in terms of the arrangements which govern sterling in the United Kingdom markets and in full recognition of the fact that in both technical matters and in more general questions of set-up and relationships there are very many differences between Canada and the United Kingdom.

It will therefore be necessary to make every sort of qualification and reservation when translating any views which I may express into terms of the Canadian scene.

that I have been out of this trade for more than a year, and am therefore rather rusty on the subject, and you will forgive me if I am not quite up to date in any comments on current affairs, because honestly since the end of June of last year I have not been following these matters as closely as I did in the preceding 20 or 25 years.

Secondly, I would just like to emphasize that I shall be speaking throughout with reference to the Bank of England and to United Kingdom market, and although I have been fortunate enough to enjoy very close contacts with the Bank of Canada for 25 years or so, and have thus followed the Canadian scene from a distance, I lay no claim to intimate knowledge of Canadian banking or financial markets; I should therefore not presume to offer advice, comment or criticism on Canadian affairs. I would therefore ask the Commission to remember that in anything I say on the technical subjects I shall be speaking from the London angle in terms of United Kingdom conditions, in terms of the arrangements which govern sterling in the United Kingdom markets and in full recognition of the fact that in both technical matters and in more general questions of set-up and relationships there are very many differences between Canada and the United Kingdom.

It will therefore be necessary to make every sort of qualification and reservation when translating any views which I may express into terms of the Canadian scene.

Finally, it will I am sure be obvious to you, sir, and to your colleagues and I would like to make it clear for the record, that any views I am expressing are entirely my own personal views and do not in any way reflect the views of the institution of which I was previously governor.

I propose, sir, to divide what I have to say into five sections, on which I sent you a brief note. Your secretary was good enough to give me a general indication of the points which he thought the Commission might like to hear from me as a visitor from Overseas, and I would propose to take the points which he underlined first, and they, by and large, cover the organization and set-up of the Bank of England, the relations of the Bank of England with Her Majesty's government and the relations of the Bank of England with the banking and financial community in the United Kingdom. I would, sir, if this is convenient, take these three different things separately, and would suggest that the Commissioners might care to ask me questions on any of these. I would then pass to what are more general points; the general effects of monetary policy on the domestic market and, lastly, the inter-relation of monetary policy with the Overseas side of things, the balance of payments, et cetera, and the contribution which Central Bank co-operation can make in the general arena of financial co-operation.

As I say, I have understood that the Commission would particularly like to hear from Overseas

Finally, it will I am sure be obvious to you, sir, and to your colleagues and I would like to make it clear for the record, that any views I am expressing are entirely my own personal views and do not in any way reflect the views of the institution of which I was previously governor.

I propose, sir, to divide what I have to say into five sections, on which I sent you a brief note. Your secretary was good enough to give me a general indication of the points which he thought the Commission might like to hear from me as a visitor from Overseas, and I would propose to take the points which he underlined first. And they, by and large, cover the organization and set-up of the Bank of England, the relations of the Bank of England with Her Majesty's government and the relations of the Bank of England with the banking and financial community in the United Kingdom. I would, sir, if this is convenient, take these three different things separately, and would suggest that the Commissioners might care to ask me questions on any of these. I would then pass to what are more general points: the general effects of monetary policy on the domestic market and, lastly, the inter-relation of monetary policy with the Overseas side of things, the balance of payments, et cetera, and the contribution which Central Bank co-operation can make in the general arena of financial co-operation.

As I say, I have understood that the Commission would particularly like to hear [illegible]

visitors like myself something about the organization and set-up in our own markets. I would like also to make this general observation; I have felt it would be more convenient to you -- and I gather that is your view, sir -- I shouldn't put in a great deal of material because I wasn't absolutely certain what sort of material would be of most use to you, nor do I intend to make statements at any length, and I think it may be easier for you to get at what you want by the method of question and answer.

I would, however, say this; I think there may be some things which come up in the course of our discussion on which you would like to have a more considered view than I could give quickly this morning; if that is so, I would be most happy if that would suit your convenience, and that of the Commissioners, to send in a memorandum or notes at a later stage giving a more considered view.

May I then start on the first of the five?

THE CHAIRMAN: The first of the five, the organization of the Bank of England; qualifications and functions of the court of directors; the role of the committee of the treasury and the relations between the governor and the court.

Would you like to make a statement on that point first, before questions are put?

LORD COBBOLD: I think that would perhaps be convenient, sir. If I may start by saying that the bank is a very old institution, dating from 1694. The development into a modern central bank has been a

visitors like myself something about the organization and set-up in our own markets. I would like also to make this general observation; I have felt it would be more convenient to you -- and I gather that is your view, sir -- I shouldn't put in a great deal of material because I wasn't absolutely certain what sort of material would be of most use to you, nor do I intend to make statements at any length, and I think it may be easier for you to get at what you want by the method of question and answer.

I would, however, say this; I think there may be some things which come up in the course of our discussion on which you would like to have a more considered view than I could give quickly this morning; if that is so, I would be most happy if that would suit your convenience, and that of the Commissioners, to send in a memorandum or notes at a later stage giving a more considered view.

May I then start on the first of the five?

THE CHAIRMAN: The first of the five, the organization of the Bank of England; qualifications and functions of the court of directors; the role of the committee of the treasury and the relations between the governor and the court.

Would you like to make a statement on that point first, before questions are put?

LORD COBBOLD: I think that would perhaps be convenient, sir. If I may start by saying that the bank is a very old institution, dating from 1694. The development into a modern central bank has been a

gradual process over the centuries and the United Kingdom financial machinery has grown and developed with and around the Bank of England. It is this gradual development and historical background which explains many of the practices and relationships of the London market, many of which derive from traditions and unwritten laws which are not applicable to markets where the development has been quicker or more recent.

I emphasize this because this fact differentiates the practice in London from the practice in other centres, and it is one of the reasons why I say that one cannot too easily translate what we do into terms of what other people either do or should or should not do. It has always been the endeavour of the Bank of England to retain what is useful in tradition and in recognized practice, but at the same time to develop and to modernize.

I say this to emphasize once again that I am very far from suggesting that the Bank of England and the London set-up would necessarily be generally appropriate or convenient for Canada. Although, as I say, there have been constant changes in development, the two biggest changes in the Bank of England structure came in two stages; the first around the turn of the century when the bank gradually withdrew from commercial business. As you will know, sir, for the first two hundred years, it was a highly competitive commercial bank and it was in the late eighteen hundreds and the early nineteen hundreds when the bank decided that they would be better out of

gradual process over the centuries and the United Kingdom financial machinery has grown and developed with and around the Bank of England. It is this gradual development and historical background which explains many of the practices and relationships of the London market, many of which derive from traditions and unwritten laws which are not applicable to markets where the development has been quicker or more recent.

I emphasize this because this fact differentiates the practice in London from the practice in other centres, and it is one of the reasons why I say that one cannot too easily translate what we do into terms of what other people either do or should or should not do. It has always been the endeavour of the Bank of England to retain what is useful in tradition and in recognized practice, but at the same time to develop and to modernize.

I say this to emphasize once again that I am very far from suggesting that the Bank of England and the London set-up would necessarily be generally appropriate or convenient for Canada. Although, as I say, there have been constant changes in development, the two biggest changes in the Bank of England structure came in two stages; the first around the turn of the century when the bank gradually withdrew from commercial business. As you will know, sir, in the first [illegible] years it was a [illegible] essentially commercial [illegible] it was in the [illegible] eighteen hundreds and the early nineteen hundreds when the bank decided that they would be better out of

competitive commercial business, and it was only by withdrawing from commercial business that they could gain the confidence of the banking community and act as a modern central bank.

The second change has taken place in the last thirty years, largely corresponding with the much greater activity of government in the financial business which has, of course, in terms of the long historical background altered the basis of relations between the Central Bank and the government.

I say that change has taken place over the past thirty years, but I think I should specify a little more. The first real change was in 1931, and the years immediately before and immediately after when the exchange equalization account was set up and Her Majesty's government more or less took direct responsibilities for the foreign exchanges and, as you will know, the Bank of England has throughout acted as the advisor and operator of the exchange equalization account although the responsibility and the ultimate decisions have lain with Her Majesty's government.

The second big change took place on the outbreak of war in September, 1939, with the setting up of the exchange control, which was administered by the Bank of England for the account of Her Majesty's government and with the general concentration of financial and banking arrangements in the United Kingdom for the prosecution of the war effort, which brought both the government and the

commercial commercial business, and it was only by withdrawing from commercial business that they could gain the confidence of the banking community and act as a proper central bank.

The second change has taken place in the last thirty years, largely corresponding with the much greater activity of government in the financial business which has, of course, in terms of the long historical background altered the basis of relations between the Central Bank and the government.

I say that change has taken place over the past thirty years, but I think I should specify a little more. The first real change was in 1932, and the years immediately before and immediately after when the exchange equalisation account was set up and Her Majesty's government more or less took direct responsibilities for the foreign exchanges and, as you will know, the Bank of England has throughout acted as the advisor and operator of the exchange equalisation account although the responsibility and the ultimate decisions have lain with Her Majesty's government.

The second big change took place on the outbreak of war in September, 1939, with the setting up of the exchange control, which was administered by the Bank of England for the account of Her Majesty's government and with the general concentration of financial and banking arrangements in the United Kingdom for the prosecution of the war effort, which brought both the government and the

central bank into very much closer contact and gave them much greater responsibility for the financial mechanism than they had before.

The third change was, of course, the Nationalization Act of 1946, to which I will refer in rather more detail a little bit later. The present court of directors consists of 16 directors, plus the governor and deputy governor. All eighteen are appointed by the Queen which, of course, means on the advice of the Prime Minister and the government of the day. There is no formal representation of particular interests; that is to say, there has never been any suggestion that industry should nominate a member or shipping should nominate a member, or that the trade union council should nominate a member. The objective has been to get the best men available for the court of directors covering a wide cross-section and making sure that there is adequate representation, not only on banking and finance, but on industry, shipping, commerce, insurance, et cetera, and the trade unions.

The practice has been that directors have been appointed often by one administration for a four year term, and have more or less regularly been re-appointed by the same administration or by the administration in power at the time of re-appointment, and we have for long had a voluntary age limit of 70, and by and large the practice has been that people stay on and move out when they are at or nearing the retiring age.

[illegible]
much greater responsibility for the financial [illegible]

[illegible] of course, the Nationalization Act of 1946, to which I will refer in rather more detail a little bit later. The present court of directors consists of 16 directors, plus the governor and deputy governor. All eighteen are appointed by the Queen which, of course, means on the advice of the Prime Minister and the government of the day. There is no formal representation of particular interests; that is to say, there has never been any suggestion that industry should nominate a member or shipping should nominate a member, or that the trade union council should nominate a member. The objective has been to get the best men available for the court of directors covering a wide cross-section and making sure that there is adequate representation, not only on banking and finance, but on industry, shipping, commerce, insurance, et cetera, and the trade unions.

The practice has been that directors have been appointed often by one administration for a four year term, and have more or less regularly been re-appointed by the same administration or by the administration in power at the time of re-appointment, and we have for long had a voluntary age limit of 70, and by and large the practice has been that people stay on and move out when they are at or nearing the retiring age.

Of the 16 directors, four can be appointed by the court -- and this is an important point -- as executive directors, and they take charge under the governors of the different activities of the bank. The court also appoints the committee of the treasury; that is an ancient name and sometimes causes some confusion because it suggests in many people's minds a connection with Her Majesty's treasury or the government.

Of course, that is not at all the case; the committee of treasury is an executive committee of the court, entirely elected by the court, which the governors notify and consult in considerably more detail than it is practical to do with a court of 18 members. Both the court and the committee of treasury meet once every week and occasionally, in times of particular preturbation, the committee of treasury will meet more often than that, either formally or informally.

I think it would be convenient, sir, to just put on the record something which I sent to you and which represents a statement which I made on this subject to the Radcliffe committee at the time, and which still represents the opinions which I hold.

Would you ask, sir, whether I am audible in the room?

THE CHAIRMAN: Unanimously, yes.

LORD COBBOLD: The first responsibility for formulating policy, for tendering advice to Her Majesty's government and for market operations,

Of the 16 directors, four can be appointed by the court -- and this is an important point -- as executive directors, and they take charge under the governors of the different activities of the bank. The court also appoints the committee of the treasury; that is an ancient name and sometimes causes some confusion because it suggests in many people's minds a connection with Her Majesty's treasury or the government.

Of course, that is not at all the case; the committee of treasury is an executive committee of the court, entirely elected by the court, which the governors notify and consult in considerably more detail than it is practical to do with a court of 18 members. Both the court and the committee of treasury meet once every week and occasionally, in times of particular preturbation, the committee of treasury will meet more often than that, either formally or informally.

I think it would be convenient, sir, to just put on the record something which I sent to you and which represents a statement which I made on this subject to the Radcliffe committee at the time, and which still represents the opinions which I hold.

Would you ask, sir, whether I am audible in the room?

THE CHAIRMAN: Unanimously, yes.

LORD COBBOLD: The first responsibility for formulating policy, for tendering advice to Her Majesty's government and for market operations,

naturally falls on the governors. They have at their disposal advice and assistance from the executive directors and the permanent staff of the bank, but under the present system they also have a great advantage of being able to consult the part-time directors individually or collectively on general or particular matters with secrecy and continuity and with the directors knowing they may have to share responsibility for decisions which are based partly on the views which they individually express.

The directors of the bank cover between them a very wide range of interests in banking, industry, commerce, trade unions, shipping and insurance. They are all practical men with a wide and up-to-date knowledge of events at home and abroad, and it is quite invaluable to the governors to be able to draw from this fund of knowledge and experience in formulating and executing policy and in tendering advice to the government.

The functions and responsibilities of the part-time directors vary in the different activities of the bank. There is no field in which general knowledge of their views and even particular consultation is not of benefit to the governors; particularly in the domestic affairs of the bank both on the court and in sub-committees they play a very active and continuous role.

In the field of monetary policy the court is directly concerned with matters which are the bank's immediate responsibility. On the general control of the money market, although no formal decision is asked of the court except in the matter of bank rate where they make a formal decision, reports are regularly given to the court or the committee of treasury and it is open to either body to query the governor's policy.

The court are not especially concerned with the bank's activities in foreign exchanges where the bank acts as agent for Her Majesty's treasury and where no statutory obligation lies on the bank, but here, again, as in other activities of the bank, the governors continually bear in the mind the general views of their colleagues, and frequently ask for individual or collective opinions on particular situations.

The strength and independence of thought of the Bank of England derives largely from a court constituted on the present lines taking an active and continuous part in forming policy. The bank owes much of its standing, and the confidence which it enjoys at home and abroad, to the knowledge that the actions taken by the governor have the support of the wide experience of the court of directors. If the nature of the court were to be altered so that it were not to be composed of active practical men of business, or if the directors were to become mere figure-heads divorced from the real affairs of the bank, the standing of the Bank of England and its ability to perform its public duties would both be gravely prejudiced.

In the field of monetary policy, the court is [illegible]

directly concerned with matters which are the bank's

statutory responsibility [illegible]

the money market, although no formal decision is asked of the court except in the matter of bank rate where they make a formal decision, reports are regularly given to the court or the committee of treasury and it is open to either body to query the governor's policy.

The court are not especially concerned with the bank's activities in foreign exchanges where the bank acts as agent for Her Majesty's treasury and where no statutory obligation lies on the bank, but here, as in other activities of the bank, the governors continually bear in mind the general views of their colleagues, and frequently ask for individual or collective opinions on particular situations.

The strength and independence of thought of the Bank of England derives largely from a court constituted on the present lines taking an active and continuous part in forming policy. The bank owes much of its standing, and the confidence which it enjoys at home and abroad, to the knowledge that the actions taken by the governor have the support of the wide experience of the court of directors. If the nature of the court were to be altered so that it were not to be composed of active practical men of business, or if the directors were to become mere figure-heads divorced from the real affairs of the bank, the standing of the Bank of England and its ability to perform its public duties would both be gravely prejudiced.

I think, sir, that concludes what I have to say initially on the first part.

COMMISSIONER BROWN: Lord Cobbold, I wonder if I may ask you one or two questions in detail on this. These are things that you know about and which we do not. I wonder if you could tell us something about the recruitment and appointment of the executive directors. Do they come up from within the bank itself, or do they come from outside?

LORD COBBOLD: Either way, sir. This, of course, is a rather modern development, and I would almost say that the bank is still feeling its way in this matter. I am not absolutely certain of my dates but, by and large, there was one executive director dating from about 1915 or 1916, and then this post fell into abeyance again. There was another executive director appointed in about 1933, and I think two more were appointed in 1938, of whom I was one. In the last 15 years it has become more or less established that there should be four. The statutory rule is that the court may elect up to four executive directors. Of the present four executive directors two have been on the staff of the Bank of England throughout their lives. One came in as an adviser some 15 years ago. He was originally a member of the Indian Civil Service and was secretary to the Viceroy and he joined us after that, so that the origins of his career were outside but he had eight or nine years inside the bank before he became an executive director.

The fourth also had some outside experience

[illegible]

to say [illegible]

COMMISSIONER BROWN: Lord Cobbold, I wonder if I may ask you one or two questions in detail on this. These are things that you know about and which we do not. I wonder if you could tell us something about the [illegible] of [illegible] directors. Do they come up from within the bank itself, or do they come from outside?

[illegible] Executive [illegible], of course, is a rather modern development, and I would almost say that the bank is still feeling its way in this matter. I am not absolutely certain of my dates but, by and large, there was one executive director dating from about 1915 or 1916, and then this post fell in abeyance again. There was another executive director appointed in about 1933, and I think two more were appointed in 1938, of whom I was one. In the last 15 years it has become more or less established that there should be four. The statutory rule is that the court may elect up to four executive directors. Of the present four executive directors two have been on the staff of the Bank of England throughout their lives. One came in as an adviser some 15 years ago. He was originally a member of the Indian Civil Service and was secretary to the Viceroy and he joined us after that, so that the origins of his career were outside but he had eight or nine years inside the bank before he became an executive director.

The fourth also had some outside experience

in legal fields and had a distinguished war career. He came into the bank into the fairly high ranks on the advisory side immediately after the war.

I think you could say that the general practice -- and I would not wish this to be any sort of commitment, but the general idea, certainly in my mind during my governorship, was that of the four executive directors the ideal was that two should be professional banking men and the other two should come in from outside, and perhaps one, or both of them, should have had a considerable initial period in banking before they came into the court. However, I would by no means exclude the possibility that one, or possibly two, executive directors might come in straight from outside, and, indeed, in the case of the first director of the present regime who came in in 1933, he did come in directly from outside. There is no rule about it. The bank is feeling its way, but that, I would say, is the general practice and the general theory.

COMMISSIONER BROWN: Do they individually have responsibility for particular departments of the bank?

LORD COBBOLD: There again that is, to some extent, experimental and very flexible. The arrangements in recent years and during my time were that two of the executive directors were generally responsible for overseas matters. One was responsible for internal monetary matters and contact with the markets, and one was responsible for departmental and staff questions, but, that, as I say, is flexible. There is nothing laid

in legal fields and had a distinguished war career. He came into the bank into the fairly high ranks on the advisory side immediately after the war.

I think you could say that the general practice -- and I would not wish this to be any sort of commitment, but the general idea, certainly in my mind during my governorship, was that of the four executive directors the ideal was that two should be professional banking men and the other two should come in from outside, and perhaps one, or both of them should have had a considerable initial period in banking before they came into the court. However, I would by no means exclude the possibility that one, or possibly two, executive directors might come in straight from outside, and, indeed, in the case of the first director of the present regime who came in in 1955 he did come in directly from outside. There is no rule about it. The bank is feeling its way, but that, I would say, is the general practice and the general theory.

[illegible] responsibility for [illegible] here?

LORD COBBOLD: There again that is, to some extent, experimental and very flexible. The arrangements in recent years and during my time were that two of the executive directors were generally responsible for overseas matters. One was responsible for internal monetary matters and contact with the markets, and one was responsible for departmental and staff questions, but, that, as I say, is flexible. There is nothing in

down on that, and it could be developed or changed as conditions and other matters develop.

We have had, as I say, two on overseas exchange matters in recent years because that has been such a very important side of our activity, and we have found in practice that one of them is almost always overseas, and we need two of them in order to have someone regularly at base. During the war the arrangement was slightly different. During that time there was not the same need for travel, or the possibility of it. I was myself the executive director in charge of the overseas and exchange part of the bank during the war, and at that time I was the only one on the overseas side. Actually, we had only three executive directors during the war period.

COMMISSIONER BROWN: With respect to the part-time directors I gather that they work at different duties as well as being members of the board?

LORD COBBOLD: Yes, certainly. We have a general rule that on all committees there is a majority of part-time directors, so that we keep the influence of the court very closely at work on these committees. They are mainly connected with the internal administration of the bank, with the exception of the committee of treasury.

For example, there is a staff committee, an audit committee, a committee for the control of expenditure, an investments committee, and so on. That is mainly concerned with what we would call the housekeeping of the bank in which it

[illegible] that, and it could be developed or changed as [illegible]issions and other matters develop.

We have had, as I say, two on overseas exchange matters in recent years because that has been such a very important side of our activity, and we have found in practice that one of them is almost always overseas, and we need two of them in order to have someone regularly at base. During the war the arrangement was slightly different. During that time there was not the same need for travel, or the possibili[illegible] of it. I was myself the executive director in charge [illegible] war, and at that time I was the only one on the overseas side. Actually, we had only three executive directors during the war period.

COMMISSIONER BROWN: With respect to the part-time directors I gather that they work at different [illegible]

LORD COBBOLD: Yes, certainly. We have a general rule that on all committees there is a majority of part-time directors, so that we keep the influence of the court very closely at work on these committees. They are mainly connected with the internal administration of the bank, with the exception of the committee of treasury.

For example, there is a staff committee, an audit committee, a committee for the control of expenditure, an investments committee, and so on. [illegible] mainly concerned with what [illegible] housekeeping of the bank in which it

has always been the bank's tradition that the outside directors should keep a very firm hand on that side of the business.

We do not have formal court committees on such things as monetary policy or the exchanges, and, as I said in my earlier statement, in those matters the services of the part-time directors would be much more directed towards being available to the governor, and the governor would consult any member of the court on any particular matter on which he thinks his opinion would be particularly valuable. Obviously there are some members of the court who are particularly well informed on overseas exchange matters, and it would be normal for the governor to have their views pretty well continuously on that side of the house.

COMMISSIONER BROWN: Are the meetings of the court more or less formal?

LORD COBBOLD: Very highly formal.

COMMISSIONER BROWN: In the sense that it would be unusual for the court not to follow your advice?

LORD COBBOLD: Very unusual, but that does not mean that the court are ciphers. The semi-formal or accepted practice is that the court does not over-rule the committee of treasury which is its own executive committee elected from its own members. By and large, if I may use slightly informal parlance, the governor can take it that if he has squared the committee of treasury he will be all right with the court.

That is the general understanding, but in any important matter on which the governor felt there were

[illegible] bank's tradition that the outside directors should keep a very firm hand on that side of the business.

We do not have formal court committees on such things as monetary policy or the exchanges, and, as I said in my [illegible] the services of the part-time directors would be much more directed towards being available to the governor and the governor would consult any member of the court on any particular matter on which he thinks his opinion would be particularly valuable. Obviously there are some members of the court who are particularly well informed on overseas exchange matters, and it would be normal for the governor to have their views pretty well continuously on that side of the house.

COMMISSIONER BROWN: Are the meetings of the court more or less formal?

LORD COBBOLD: Very highly formal.

COMMISSIONER BROWN: In the sense that it would be unusual for the court not to follow your advice?

LORD COBBOLD: [illegible] not mean that the court are ciphers. The semi-formal or accepted practice is that the court does not over-rule the committee of treasury [illegible] committee elected from its own members. By and large, if I may use slightly informal parlance, the governor can take it that if he has squared the committee of treasury he will be all right with the court.

That is the general understanding, but in any important matter on which the governor felt there was

likely to be different or conflicting views then, speaking for myself, I would most certainly make quite sure before I took that matter to court that I had the court pretty solidly behind me by discussing matters with them beforehand. The committee of treasury is by no means a formal body, and matters would be discussed very fully, and a very full account taken of the views of the part-time directors on the committee of treasury. Again, as a matter of practice but not of statute, the committee of treasury has always a majority of part-time directors.

COMMISSIONER BROWN: Are the executive directors on the committee of treasury?

LORD COBBOLD: There is one as a rule, but not more. The governor and the deputy governor are _ex officio_ members of the committee of treasury.

COMMISSIONER BROWN: If the meetings of the court are fairly formal what particular advantage do you find in having the executive directors, who are your full-time directors, also members of the court?

LORD COBBOLD: More, I think, sir, as a matter of status, really. We try to differentiate as little as possible between executive directors and directors. They are all directors, and we have tried to build up a sense of corporate responsibility. Some of those people take a full-time responsibility and some of them take a part-time responsibility, but they speak to each other as equals. There is no question of the executive directors being officials or being in any way subservient to the directors, and we have

likely to be different or conflicting views then, speaking for myself, I would most certainly make quite sure before I took that matter to court that I had the court pretty solidly behind me by discussing matters with them beforehand. The committee of treasury is by no means a formal body, and matters would be discussed very fully, and a very full account taken of the views of the part-time directors on the committee of treasury. Again, as a matter of practice but not of statute, the committee of treasury has always a majority of part-time directors.

COMMISSIONER BROWN: Are the executive directors on the committee of treasury?

LORD COBBOLD: There is one as a rule, but not more. The governor and the deputy governor are ex officio members of the committee of treasury.

COMMISSIONER BROWN: If the meetings of the court are fairly formal what particular advantage do you find in having the executive directors, who are your full-time directors, also members of the court?

LORD COBBOLD: More, I think, sir, as a matter of status, really. We try to differentiate as little as possible between executive directors and directors. They are all directors, and we have tried to build up a sense of corporate responsibility. Some of those people take a full-time responsibility and some of them take a part-time responsibility, but they speak to each other as equals. There is no question of the executive directors being officials or being in any way subservient to the directors, and we have

found that practically that is a very considerable corporate advantage. I think I would put it like that.

COMMISSIONER BROWN: What I am getting at is if, in fact, the executive directors would not be taking any greater part in the discussion in the formal court meetings than the outside --

LORD COBBOLD: Not in the formal court meetings, but, of course, they would be taking part in the discussions day by day with the governors beforehand. I think your point is: Why have them as members of the court and as directors: In the olden days that was not the practice, and then the governors discussed policy with the officials and then took it to the court. As I say, it is largely a question of status both to make the executive director a part of the corporate body of the court and to give him that status in relation with his dealing with other members of the court. I think,perhaps it would help you if I gave a specific instance.

For example, an executive director in charge of the foreign exchange under the present arrangements would be perfectly entitled to ring up as an equal three or four of the other directors who he thought knew something in particular about Brazil, or about India, or about Japan, and ask him for his opinion, or to ask him to come in and talk to him as an equal, and not as an official talking to a director.

The other side, which is also to some extent a status side, is that it is immensely valuable for the governor to be able to send an executive director over

[illegible] ...lly that is a very considerable corporate advantage. I think I would put it like that.

COMMISSIONER BROWN: What I am getting at is, if, in fact, the executive directors would not be taking any greater part in the discussion in the formal court meetings than the outside --

LORD COBBOLD: Not in the formal court meetings, but, of course, they would be taking part in the discussions day by day with the governors beforehand. I think your point is: Why have them as members of the court and as directors? In the olden days that was not the practice, and then the governors discussed policy with the officials and then took it to the court. As I say, it is largely a question of status both to make the executive director a part of the corporate body of the court and to give him that status in relation with his dealing with other members of the court. I think, perhaps it would help you if I gave a specific instance.

For example, an executive director in charge of the foreign exchange under the present arrangements would be perfectly entitled to ring up as an equal three or four of the other directors who he thought knew something in particular about Brazil, or about India, or about Japan, and ask him for his opinion, or to ask him to come in and talk to him as an equal, and not as an official talking to a director.

The other side, which is also to some extent a status side, is that it is immensely valuable for the governor to be able to send an executive director

to international meetings. We have found that a person who is a member of the court can represent the governor of the bank at meetings of the International Monetary Fund or the European Payments Union, or even in discussions with other central banks and at meetings with other central banks.

It gives those persons added standing and authority, and in the present day with one governor and one deputy governor who cannot be rushing around all the time it has helped us enormously to have someone who can speak as a director and not only as an official. That is true also, to some extent, in our London contacts with other banks and in touring around the provinces in England.

I do not say the same work could not be done as an official, but we have found it much more practical and a much better arrangement to have people speaking with that added authority, and also people who can discuss matters as equals with their part-time colleagues.

COMMISSIONER BROWN: The most notable contrast between the part-time directors of the Bank of England and the part-time directors of the Bank of Canada is in this business of having representation from banking and finance. It is not permitted under the Canadian statute, as you so well know. My understanding is that the practice in England is that you do not have representatives from the clearing banks but you do have them from the merchant banking fraternity. What problems do you have about conflict of interest? Perhaps there

in international meetings, [illegible] at the [illegible] of the International [illegible] or the European Payments Union, or even in discussions with other [illegible]

other central banks.

It gives those persons added standing and authority, and in the present day with one governor and one deputy governor who cannot be rushing around all the time it has helped us enormously to have someone who can speak as a director and not only as an official. That is true also, to some extent, in our London contacts with other banks and in touring around the provinces in England.

I do not say the same work could not be done as an official, but we have found it much more practical and a much better arrangement to have people speaking with that added authority, and also people who can discuss matters as equals with their part-time colleagues.

[illegible] contrast between the part-time directors of the Bank of England and the part-time directors of the Bank of Canada is in this business of having representation from banking and finance. It is not permitted under the Canadian statute, as you so well know. My understanding is that the practice in England is that you do not have representatives from the clearing banks but you do have [illegible] conflict of interests? [illegible]

have been one or two matters that have given rise to public discussion recently, but in practice it does not appear to be a serious problem.

LORD COBBOLD: In practice, in my experience, I have never found that a difficult problem. As I said in evidence before the Parker Tribunal, in my experience almost everybody has problems of conflict of interest.

Anybody who sits on two or more boards of directors quite certainly has a conflict of interest at certain times. Lawyers, again, I think, have different clients, and very frequently I should think they are faced with a conflict of interest. Chartered accountants who know the business of a number of different clients certainly do.

My personal experience is that people who have reached the sort of grade that one expects of directors of the Bank of England know very well how to differentiate their interests.

On the question of the clearing bank directors it has, as you say, been the general practice not to have directors from the clearing banks, although as a matter of fact there is at the moment one director from one of the smaller clearing banks.

That, again, ties in a little bit with the historical background and the gradual development that I was talking about. A hundred years ago the majority of the court would have been from the finance houses, the accepting houses and private banks. The composition of the court has been very much changed since then, and I think that now there are four from the houses

[illegible]

[illegible]

[illegible]

LORD COBBOLD: In practice, in my experience,

[illegible]

[illegible]

almost everybody has problems or conflict of interest.

Anybody who sits on two or more boards of directors quite certainly has a conflict of interest at certain times. Lawyers, again, I think, have different clients, and very frequently I should think they are faced with a conflict of interest. Chartered accountants who know the business of a number of different [illegible]

My personal experience is that people who have reached the sort of grade that one expects of directors of the Bank of England know very well how to differentiate their interests.

On the question of the clearing bank directors it has, as you say, been the general practice not to have directors from the clearing banks, although as a matter of fact there is at the moment one director from one of the smaller clearing banks.

That, again, ties in a little bit with the historical background and the gradual development that I was talking about. A hundred years ago the majority of the court would have been from the finance houses, the accepting houses and private banks. The composition of the court has been very much changed since then, and I think that now there are four from the houses

and the majority of the directors comes from industry, commerce and other parts. But, it has grown up to be a tradition that there is a certain amount of accepting house-merchant bank representation on the court, and that has been proved extremely convenient. I would not by any means attempt to lay down a principle that there should never be a clearing bank director appointed. We have felt that on the whole it is easier to deal between the Bank of England and the clearing banks through the chairman of the day of the clearing banks committee, and that it might be embarrassing if Bank X were represented on the court and Bank Y were to provide the chairman of the clearing banks committee. I do not think it would be a great embarrassment, but it seems to fit slightly better that we should have the accepting house people on the court.

As I say, I would not attempt to lay down anything definite. We have, in a sense, felt our way by having one member of the court from one of the smaller clearing banks.

COMMISSIONER MACKINTOSH: What about discount houses?

LORD COBBOLD: We have always made it a definite rule that no member of a discount house should be on the court. There would be a very definite conflict of interest there which would be difficult and embarrassing.

THE CHAIRMAN: Are there any further questions on this point?

COMMISSIONER GIBSON: Lord Cobbold, I would

and the majority of the [illegible] from [illegible] [illegible] and other parts. But, it has grown up to be a [illegible] that there is a [illegible] of accepting [illegible] on the court, and that has been proved extremely convenient. I would not by any means attempt to lay down a principle that there should never be a clearing bank director appointed. We have felt that on the whole it is easier to deal between the Bank of England and the clearing banks through the chairman of the day of the clearing banks committee, and that it might be embarrassing if Bank X were represented on the court and Bank Y were to provide the chairman of the clearing banks committee. I do not think it would be a great embarrassment, but it seems to fit slightly better that we should have the accepting house people on the court.

As I say, I would not attempt to lay down anything definite. We have, in a sense, felt our way by having one member of the court from one of the smaller clearing banks.

COMMISSIONER [illegible]: [illegible] [illegible]?

LORD COBBOLD: We have always made it a definite rule that no member of a discount house should be on the court. There would be a very definite conflict of interest there which would be difficult and embarrassing.

THE CHAIRMAN: Are there any further questions on this point?

COMMISSIONER GIBSON: Lord Cobbold, I would

like to ask you a little more about the part of the executive directors. Do the executive directors and the governor and the deputy governor, in fact, form a sort of forum where the basic issues of monetary policy are discussed, or where policy matters are discussed? Do you throw out your ideas to them?

LORD COBBOLD: Certainly, yes, not quite in the sense of direktorium of the old Reichsbank, if you are conversant with that, which definitely had a corporate responsibility as an executive direktorium, because, as I was saying just now, we try as much as possible to keep part-time directors and executive directors in the same degree of corporate responsibility in the business of the bank as a whole.

I think I can best answer your question by giving you a practical picture. There is a meeting every day with the four executive directors and one or two of the top officials which is taken either by the governor or the deputy governor. The governor always takes it on Wednesdays and Thursdays which are committee of treasury and court days. The economic adviser would also appear on those days, and then we have a rather longer and more general discussion. There is a morning meeting every other day, which is taken by either the governor or the deputy governor, with the four deputy directors and possibly one or two officials just to run through the business of the day.

. Do the executive directors and the governor and the deputy governor, in fact, form a sort of forum where the basic issues of monetary policy are discussed, or where policy matters are discussed? Do you throw out your ideas to them?

LORD COBBOLD: Certainly, yes, not quite in the sense of direktorium of the old Reichsbank, if you are conversant with that, which definitely had a corporate responsibility as an executive directorium, because, as I was saying just now, we try as much as possible to keep part-time directors and executive directors in the same degree of corporate responsibility in the business of the bank as a whole.

I think I can best answer your question by giving you a practical picture. There is a meeting every day with the four executive directors and one or two of the top officials which is taken either by the governor or the deputy governor. The governor always takes it on Wednesdays and Thursdays which are committee of treasury and court days. The economic adviser would also appear on these days, and then we have a rather longer and more general discussion. There is a meeting every other day, which is taken by either the governor [illegible] and possibly one or two officials just to run through the business of the day.

COMMISSIONER GIBSON: You would be talking about matters of direction of monetary policy?

LORD COBBOLD: Particularly on the two more important days. By and large twice a week we would be doing that; and, of course, very often the governor would call perhaps two, perhaps three, perhaps four executive directors, with the official particularly concerned with that side of the business, together with the economic advisors, if necessary, to discuss that particular problem in the ordinary course of administration. But you can take it that all the executive directors are generally acquainted with all aspects of what the bank is doing, and would be included in the discussion of a particular aspect. The governor would certainly not move without the advice and full knowledge and without full discussion with the executive director handling that particular side of the business.

COMMISSIONER GIBSON: When you decide that you whould move a little this way or a little that way in the direction of your policy, a little tighter or a little easier, would it be accurate to say that this would be a decision made by the governor, with the advice of the appropriate people, or is it to any extent a group decision, as in the case of the United States?

LORD COBBOLD: I would say it is rather more the decision of the governor.

COMMISSIONER GIBSON: It is more the decision of the governor?

COMMISSIONER GIBSON: [illegible]

[illegible]

[illegible]

[illegible] important days. By and large twice a week we [illegible] four executive directors, with the official particularly concerned with that side of the business, together with the economic advisors, if necessary, to discuss that particular problem in the ordinary course of administration. But you can take it that all the executive directors are generally acquainted with all aspects of what the bank is doing, and would be included in the discussion of a particular aspect. The governor would certainly not move without the advice and full knowledge and without full discussion with the executive director handling that particular side of the business.

COMMISSIONER GIBSON: When you decide that you should move a little this way or a little other way in the direction of your policy, a little tighter or a little easier, would it be accurate to say that [illegible]

LORD COBBOLD: I would say it is rather more the decision of the governor.

COMMISSIONER GIBSON: It is more the decision of the governor?

LORD COBBOLD: After consulting a great number of people. I think it is easier to explain this by taking a specific case. If one were discussing a bank rate move, or a tightening or easing up move, the general line of approach would be that one would discuss it first, probably, with the individual executive director handling that particular side of the business, and one would probably discuss it three or four times. I have known times when we have had up to seven meetings in a single day. The matter would be fully discussed with the executive directors and one or two of the chief officials, economic advisors and either contemporaneously or just a little later the governor would probably be discussing it with some or all the outside members of the committee of treasury, to be sure they were lined up in the same direction, or to see if they had any comment.

COMMISSIONER GIBSON: This is very interesting. If one of the executive directors who was not necessarily very closely related to a general policy decision, had a different view, would he, in the normal course of events, come and tell you that he had a different view?

LORD COBBOLD: Certainly. And how, if I may say so.

COMMISSIONER GIBSON: So, in other words, you would be banging the sort of major issues around among yourselves quite a lot?

LORD COBBOLD: Yes, indeed. If I might

[illegible]

[illegible]. I think it is easier to explain this by taking a specific case. If one were [illegible] easing up move, the general line of approach would be that one would discuss it first, probably, with the [illegible] side of the business, and one would probably discuss it three or four times. I have known times when we have had up to seven meetings in a single day. The matter would be fully discussed with the executive directors and one or two of the chief officials, economic advisors and either contemporaneously or just a little later the governor would probably be discussing it with some or all the outside members of the committee of treasury, to be sure they were lined up in the same direction, or to see if they had any comment.

COMMISSIONER GIBSON: This is very interesting. If one of the executive directors who was not necessarily very closely related to a general policy decision, had a different view, would he, in the normal course of events, come and tell you that he had a different view?

[illegible]

I may say so.

COMMISSIONER GIBSON: So, in other words, you would be banging the sort of major issues around [illegible] yourselves quite a lot?

LORD COBBOLD: Yes, indeed. If I might

say so, it is very often the executive directors and part-time members of the committee of treasury who are not concerned with a particular item who bring up some objections which are very valid and need disposing of before you can go ahead with it.

I have known a number of times when the executive director responsible for staff and internal administration had asked very pertinent questions from the point of view, as he always puts it, of "the man in the street".

COMMISSIONER GIBSON: There is one other question I would like to ask. In the statement which you made to us you observed that these decisions were made by the court of directors knowing that they may have to share responsibility for decisions, based partly on the views which they individually expressed. Is there any particular significance to saying that the directors share responsibility for the decisions?

LORD COBBOLD: Well, I feel so, sir. It has always been my view, in business generally, that if you ask somebody whether he thinks something is a good idea or not, as an outside individual he may give you advice or he may say what he thinks that he would like to hear. If he knows that he is going to be responsible for the decision, his attitude in the matter is going to be different, and he is apt to be a little more precise and certainly more helpful.

COMMISSIONER GIBSON: I suppose that many of the decisions that are formally taken by the court, though, would be decisions in which some directors would

may be, it is very often the executive directors and part-time members of the committee of treasury who are not concerned with a particular item who bring up some objections which are very valid and need disposing of before you can go ahead with it.

I have known a number of times when the executive director responsible for staff and internal administration had asked very pertinent questions from the point of view, as he always puts it, of "the man in the street".

COMMISSIONER GIBSON: There is one other question I would like to ask. In the statement which you made to us you observed that these decisions were made by the court of directors knowing that they may have to share responsibility for decisions, based partly on the views which they individually expressed. Is there any particular significance to saying that the directors share responsibility for the decisions?

LORD COBBOLD: Well, I feel so, sir. It has always been my view, in business generally, that if you ask somebody whether he thinks something is a good idea or not, as an outside individual he may give you advice or he may say what he thinks that he would like to hear. If he knows that he is going to be responsible for the decision, his attitude in the matter is going to be different, and he is apt to be a little more precise and certainly more helpful.

COMMISSIONER GIBSON: I suppose that many of the decisions that are formally taken by the court, largely, would be [illegible]

not have had much part?

LORD COBBOLD: In the case of any important decision any member of the court would have an opportunity of telling the governor that he did not agree with it, before it was taken, and he would be fully entitled to say in a very loud voice if he did not agree with it, and he could expect to have his reasons dealt with. I do not say a director would resign. Obviously, if there is a big majority in favour, as in the normal course in any business, a lot of people are prepared to go along with the majority, having expressed their individual view. He would have a full opportunity of having his objections considered.

COMMISSIONER GIBSON: In making your statement you are emphasizing your view that directors ought to speak up and make their own position quite clear?

LORD COBBOLD: I think, to their colleagues, but not afterwards. I should take a poor view if somebody got up immediately after the decision is taken and said they did not agree with it. But, certainly, in the course of decision-forming directors have the full right to make their viess known.

I should regard it as part of the business of the governor to know their views generally, not as to whether bank rate should be $5\frac{1}{4}$ or $5\frac{1}{2}$ per cent, but the governor would normally know currently, by seeing all the part-time directors a couple of times a week, probably, for a chat or talk, what their view was about

[illegible]

LORD COBBOLD: In the case of any important decision any member of the court would have an opportunity of telling the governor that he did not agree with it, before it was taken, and he would be [illegible] did not agree with it, and he could expect to have his reasons dealt with. I do not say a director would resign. Obviously, if there is a big majority in favour, as in the normal course in any business, a lot of people are prepared to go along with the [illegible] He would have a full opportunity of having his objections considered.

COMMISSIONER GIBSON: In making your statement you are emphasizing your view that directors ought to speak up and make their own position quite clear?

LORD COBBOLD: I think, to their colleagues but not afterwards. I should take a poor view if somebody got up immediately after the decision is taken and said they did not agree with it. But, certainly, in the course of decision-forming directors have the full right to make their views known.

I should regard it as part of the business of the governor to know their views generally, not as to whether bank rate should be $5\frac{1}{4}$ or $5\frac{1}{2}$ per cent, but the governor would normally know currently, by seeing all the part-time directors a couple of times a week, probably, for a chat or talk, what their view was about

whether there was too much economic activity or too little. One would reckon to know their mind currently, without necessarily consulting them on every particular point. If I knew fourteen members of the court, say, generally thought we ought to tighten up a bit and two thought we ought to loosen up a bit, I should have some very long conversations with the two before we took it to the formal decision. Do I make myself clear?

COMMISSIONER GIBSON: Yes, thank you very much.

COMMISSIONER BROWN: Lord Cobbold, if it is a decision like that, I gather you would consult, first, the committee of the treasury, and that after that you would probably have individual consultations with most of the part-time directors before the court met?

LORD COBBOLD: It is awfully difficult to say; sometimes, yes. Normally, to avoid undue embarrassment, one would not put specific problems to other members of the court of directors before the formal meeting. Again, if I may take a specific instance, if we were considering raising the bank rate from 5 to 5½ per cent, for example, I would make it my business to ascertain in the week preceding that that the body of opinion of the part-time directors was that they thought there ought to be some tightening, without necessarily consulting them on a specific move at a specific time.

COMMISSIONER MACKINTOSH: You would feel it

whether there was too much economic activity or too [illegible] without necessarily consulting them on every particular point. If I knew fourteen members of the court, say, generally thought we ought to tighten up a bit and two thought we ought to loosen up a bit, I should have some very long conversations with the two before we took it to the formal decision. Do I make myself [illegible]

COMMISSIONER [illegible]: [illegible]

COMMISSIONER BROWN: Lord Cobbold, if it is a decision like that, I gather you would consult, first, the committee of the treasury, and that after that you would probably have individual consultations with most of the part-time directors before the court [illegible]

LORD COBBOLD: It is awfully difficult to say; sometimes, yes. Normally, to avoid undue embarrassment, one would not put specific problems to other members of the court of directors before the formal meeting. Again, if I may take a specific instance, if we were considering raising the bank rate from 5 to $5\frac{1}{2}$ per cent, for example, I would make it my business to ascertain in the week preceding that that the body of opinion of the part-time directors was that they thought there ought to be some tightening, without necessarily consulting them on a specific move at a specific time.

COMMISSIONER MACKINTOSH: You would feel it

desirable to consult all of them, assuming the change was pretty significant?

LORD COBBOLD: I would feel it desirable to know their minds. In the majority of cases I would know without consulting them, whether they felt the move should be in that direction, and I should not have to consult them specifically because one would talk to them currently, probably once or twice a week.

In England we have this great advantage, which I shall come onto, that of geographic concentration. They are all in and out, and either the governor would have talked to one of them, or the deputy governor would have talked to another of them, or one of the executive directors would have talked to another of them. With such a geographic concentration we are able to have a real corporate feeling and, by and large, know what people are thinking.

COMMISSIONER BROWN: I wonder if I might ask one supplementary question on the potential conflicts of interest? In the committee of the treasury -- which is the executive committee of the court, in effect -- is there any unwritten rule about the membership of it?

LORD COBBOLD: No.

COMMISSIONER BROWN: Among the part-time directors?

LORD COBBOLD: Except that there should not be more than one executive director, and that the majority should be non-executive.

COMMISSIONER BROWN: But they could all be

members of merchant banking institutions?

LORD COBBOLD: No, we should certainly have some industrial and commercial representation on the committee of the treasury. It is an impossible situation in modern times that the committee of treasury should be composed entirely of executive directors and banking and financial representatives. That would not happen, but there would be one or two financial representatives there.

COMMISSIONER LEMAN: Lord Cobbold, as you pointed out in your introduction, there are certain features of a country like Canada that are highly different from the type of organization existing in England. One of them is the geography. This group of people composing the court is a highly concentrated group, geographically: they are all available to the governors for consulting, on practically a moment's notice. Do you feel that is partly where their value lies, or in large part -- the fact that they are so readily available; and that in a country like Canada, if they had to take a week's trip to be available, it would not work?

LORD COBBOLD: I believe it complicates the sort of organization I am talking about very much.

COMMISSIONER LEMAN: Has there ever been any feeling in the U.K. that people who are not in the City have views that are not sufficiently sound and worthy of consideration?

LORD COBBOLD: We have, as a matter of fact, tried to meet that to a certain extent. There

LORD COBBOLD: No, we should certainly have some industrial and commercial representation on the committee of the treasury. It is an impossible situation in modern times that the committee of treasury should be composed entirely of executive directors and banking and financial representatives. That would not happen, but there would be one or two financial representatives there.

COMMISSIONER LEMAN: Lord Cobbold, as you pointed out in your introduction, there are certain features of a country like Canada that are highly different from the type of organization existing in England. One of them is the geography. This group of people composing the court is a highly concentrated group, geographically: they are all available to the governors for consulting, on practically a moment's notice. Do you feel that is partly where their value lies, or in large part -- the fact that they are so readily available; and that in a country like Canada, if they had to take a week's trip to be available, it would not work.

LORD COBBOLD: I believe it complicates the sort of organization I am talking about very much.

COMMISSIONER LEMAN: Has there ever been any feeling in the U.K. that people who are not in the City have views that are not sufficiently sound and worthy of consideration?

LORD COBBOLD: We have, as a matter of

is on the court, or there was in my time on the court, one director whose business centre was Liverpool but who was always up in London a couple of days a week. There was one whose business centre was in Birmingham who was always up in London a couple of days a week; and there was one, a little earlier, whose business centre was in Glasgow but who was up in London a couple of days, or once a week or once a fortnight. The geography is much easier, and people in those sorts of positions do tend to be in London either once a week or once in every two weeks, so you can, to some extent, combine the advantages of having people whose business centre is in a big provincial centre but who normally come up to London very often.

COMMISSIONER LEMAN: These people, if they visit London on their own business, would certainly make it their duty to pay you a call?

LORD COBBOLD: They would certainly drop in once a week, yes.

THE CHAIRMAN: We shall move to your second point, the relations between the Bank of England and Her Majesty's government. Perhaps you would wish to make a statement on that first?

LORD COBBOLD: I would rather like to.

THE CHAIRMAN: Go ahead.

LORD COBBOLD: I think it might be convenient to read into the record some of what I put to you, if that is convenient.

THE CHAIRMAN: Go ahead, please.

LORD COBBOLD: I am sorry to harp on this

[illegible]

one director whose business centre was Liverpool but who was always up in London a couple of days a week. There was one whose business centre was in Birmingham who was always up in London a couple of days a week; and there was one, a little earlier, whose business centre was in Glasgow but who was up in London a couple of days, or once a week or once a fortnight. The geography is much easier, and people in those sorts of positions do tend to be in London either once a week or once in every two weeks, so you can, to some extent, combine the advantages of having people whose business centre is in a big provincial centre but who normally come up to London very often.

COMMISSIONER LEMAN: These people, if they visit London on their own business, would certainly make it their duty to pay you a call?

LORD COBBOLD: They would certainly drop in once a week, yes.

THE CHAIRMAN: We shall move to your second point, the relations between the Bank of England and Her Majesty's government. Perhaps you would wish to make a statement on that first?

LORD COBBOLD: I would rather like to.

THE CHAIRMAN: Go ahead.

LORD COBBOLD: I think it might be convenient to read into the record some of what I put to you, if that is convenient.

THE CHAIRMAN: Go ahead, please.

LORD COBBOLD: I am sorry to harp on this

point, but I would like to repeat that I am thinking about relations between the Bank of England and Her Majesty's government in the United Kingdom, and not about relations between central banks and governments in general.

At the risk of being rather long, perhaps I may recall what I said to the Radcliffe committee on this subject, because this was a considered statement at the time, and one which I think still represents my opinion.

> " I have no doubt that in modern conditions it is proper that Government should have the final word on policy and that the central bank should not be free to pursue a completely independent line. At the same time, if the central bank is to perform a useful function, it must be a separate entity capable both of dealing professionally in markets and of forming its own views and giving independent advice to Government. Contact between Bank and Treasury must be close and continuous, but Bank and Treasury should speak to each other as separate institutions, forming their opinions from different viewpoints and different backgrounds. The Bank must be in and out of the market, must enjoy the confidence of Government on the one hand and of the market on the other, and must be in a position to interpret market opinions to

[illegible]t, but I would like to repeat that I am thinking [illegible]t relations between the Bank of England and Her Majesty's government in the United Kingdom, and not about relations between central banks and governments in general.

At the risk of being rather long, perhaps I may recall what I said to the Radcliffe committee on this subject, because this was a considered statement at the time, and one which I think still [illegible].

" I have no doubt that in modern conditions it is proper that Government should have the final word on policy and that the central bank should not be free to pursue a completely independent line. At the same time, if the central bank is to perform a useful function, it must be a separate entity capable both of dealing professionally in markets and of forming its own views and giving independent [illegible] and Treasury must be close and continuous, but Bank and Treasury should speak to each [illegible] their opinions from different viewpoints and different backgrounds. The Bank must be in and out of the market, must enjoy the confidence of Government on the one hand and of the market on the other, and must be in [illegible] position to interpret market opinions [illegible]

"Government and Government opinions to the market.

In a totalitarian state, with private enterprise and markets more or less eliminated, it would make sense for central bank operations to be handled under direct Treasury control, both as to policy and as to detail. For any country operating to a great extent with private enterprise and markets, and working with other countries similarly placed, I should regard direct Treasury control over central bank operations as a major weakness. For a country as dependent as the U.K. on international trade and confidence, it could be a disaster.

The business of the central banker is different from that of the Treasury official. Apart from the physical impossibility of the same men handling such different businesses, the necessary attitude and approach are not the same. The senior civil servant must always be concerned with his Minister's responsibilities in Government and in Parliament. The central bank should not concern itself with political or parliamentary questions. Its concern should be with the general economic and financial situation and with the day-to-day market situation, both in its own country

"and abroad: only if it is in intimate and continuous touch with markets and with business opinion can it efficiently carry out its twin functions of advising and operating.

It would, in my view, be a mistake to blur the identity and the separate responsibilities of the two: with the two institutions working so closely together," --

-- I mean, the Bank of England the treasury --

"-- there is always a tendency in that direction unless it is resisted. A policy of fusing the two by interchange of staff or otherwise would gradually but inevitably lead to a blurring of responsibilities and functions; and, as a matter of practical administration, fusion and "cross-fertilization" would, in my view, tend to prejudice rather than improve relationships.

Arguments can doubtless be advanced for variation, in either direction, in the degree of formal independence of the central bank from Government and in allocation, either by statute or in practice, of responsibilities between Bank and Treasury. But the fundamental question is whether the central bank should be a separate entity, albeit the servant of the Government of the day, or a sub-department

abroad: only if it is in intimate and continuous touch with markets and with [illegible] is it effectively [illegible] out its twin functions of advising and operating.

It would, in my view, be a mistake to blur the identity and the separate responsibilities of the two: with the two institutions working so closely together," --

-- I mean, the Bank of England the treasury --

"-- there is always a tendency in that direction unless it is resisted. A policy of fusing the two by interchange of staff or otherwise would gradually but inevitably lead to a blurring of responsibilities and functions; and, as a matter of practical administration, fusion and "cross-fertilization" would, in my view, tend to prejudice rather than improve relationships.

Arguments can doubtless be advanced for variation, in either direction, in the degree of formal independence of the central bank from Government and in allocation, either by statute or in practice, of responsibilities between Bank and Treasury. But the fundamental question is whether the central bank should be a separate entity, albeit the servant of the Government of the day, or a sub-department

"of the Treasury. I hold that, in present and foreseeable economic conditions in the Western world, the former is undoubtedly right."

That was the statement which I made to the Radcliffe committee on that subject. It so happens, Mr. Chairman, that I was deputy governor before nationalization, before the Bank Act of 1946, and deputy governor and governor since then, so I had unrivalled opportunities of seeing the degree of change before and after. The Bank Act, in fact, to some extent regularized the position which had largely come about already by the developments to which I have already referred. But it did, of course, give statutory authority to the government's ultimate control, which had not existed before. The Act was, however, so drafted as to leave the court responsible for the bank's affairs, subject to directions by the treasury, to provide for consultation by the treasury with the governor before the issue of any directions, leaving the court with full power over internal matters, such as recruiting, appointments, and salary scales.
In the outcome it has not yet proved necessary to invoke the directions clause. In practice, the bank and treasury maintain a very close contact at various levels; and, again, in practice, it has always proved possible to iron out differences of opinion and formulate an agreed line of policy without the need of the formal issuing of directions.

"of the Treasury. I hold that, in present and foreseeable economic conditions in the Western world, the former is undoubtedly right."

That was the statement which I made to the Radcliffe committee on that subject. It so happens, Mr. Chairman, that I was deputy governor before nationalization, before the Bank Act of 1946, and deputy governor and governor since then, so I had unrivalled opportunities of seeing the degree of change before and after. The Bank Act, in fact, to some extent regularized the position which had largely come about already by the developments to which I have already referred. But it did, of course, give statutory authority to the government's ultimate control which had not existed before. The Act was, however, so drafted as to leave the court responsible for the bank's affairs, subject to directions by the treasury, to provide for consultation by the treasury with the governor before the issue of any directions, leaving the court with full power over internal matters, such as recruiting, appointments, and salary scales.

In the outcome it has not yet proved necessary to invoke the directions clause. In practice, the bank and treasury maintain very close contacts at [illegible] levels; and, again, in practice, it has always proved possible to iron out differences of opinion and formulate an agreed line of policy without the need of the formal issuing of directions.

I was asked a lot at the sittings of the Radcliffe Committee and elsewhere where the initiative comes from in a number of matters -- whether it comes from government or bank. Of course, that is always a very difficult question to answer when one is in regular discussions with people, and when you take a decision it is awfully difficult to say where the idea originated two or three months earlier.

However, subject to that, by and large we regard the responsibility for initiative in monetary matters as lying with the bank. I would regard the bank and its governor as more at fault if they failed to take the initiative on a monetary problem than the Chancellor and treasury officials who have other things to do. This lies immediately in the bank's field and the first initiative on monetary matters lies with the bank. However, it would be a matter of continuous discussion, and it is not always easy to say where any particular suggestion or idea originated.

I think that is all I would have to say, sir, on that point.

COMMISSIONER HARROLD: Lord Cobbold, I had one or two questions, but you have pretty well covered what I had in mind, and on this question of statutes, initiative and ultimate control, have you found the government, on the question of tight money or the raising of interest rates, has gone to the use of the statute when there is a serious difference of opinion with the bank officials?

[illegible] bank. Of course, that is always a very difficult question to answer when one is in regular discussions with people, and when you take a decision it is awfully difficult to say where the idea originated two or three months earlier.

However, subject to that, by and large we regard the responsibility for initiative in monetary matters as lying with the bank. I would regard the bank and its governor as more at fault if they failed to take the initiative on a monetary problem than the Chancellor and treasury officials who have other things to do. This lies immediately in the bank's field and the first initiative on monetary matters lies with the bank. However, it would be a matter of continuous discussion, and it is not always easy to say where any particular suggestion or idea [illegible].

I think that is all I would have to say, [illegible].

COMMISSIONER HAROLD: Lord Cobbold, I had one or two questions, but you have pretty well covered what I had in mind, and on this question of statutes, initiative and ultimate control, have you found the government, on the question of tight money or the raising of interest rates, has gone to the use of the statute when there is a serious difference of [illegible] with the bank officials?

LORD COBBOLD: No, not down to the use of the statute. I don't think we ever got to the stage of pointing guns at each other. Obviously, there have been occasions when there have been differences of views which have had to be argued out at length, and there have been occasions on which one party or the other has accommodated itself and given way a bit here and there. If two separate institutions are trying to work together, that is an inevitable arrangement. However, broadly, the answer to your question is no.

COMMISSIONER HARROLD: It is pretty clear from what you have stated here that you think the present arrangement whereby you have a separate institution, and probably separate ways of appointing the staff, coming from different backgrounds -- the bank people and the treasury people -- you feel it is very desirable. It is probably somewhat different in Canada, but in comparing the two operations do you suggest it may be more applicable to Canada?

LORD COBBOLD: I really could not offer an opinion on that.

COMMISSIONER HARROLD: Under the conditions in the U.K.?

LORD COBBOLD: Under the conditions in the U.K. I have no doubt about that, and from this point of view: That if the Bank of England were exactly the same animal as the treasury in the sense it recruited the same sort of people and thought from the same basis, there is no point in having two animals. It is much cheaper and more effective to have one animal. The

LORD COBBOLD: No, not down to the use of the [illegible]. I don't think we ever got to the stage of pointing guns at each other. Obviously, there have been occasions when there have been differences of views which have had to be argued out at length, and there have been occasions on which one party or the other has accommodated itself and given way a bit here and there. [illegible] that is an inevitable arrangement. However, broadly, the answer to your question is no.

COMMISSIONER HARROLD: It is pretty clear from what you have stated here that you think the present arrangement whereby you have a separate institution, and probably separate ways of appointing the staff, coming from different backgrounds -- the bank people and the treasury people -- you feel it is very desirable. It is probably somewhat different in Canada, but in comparing the two operations do you suggest it may be more applicable to Canada?

LORD COBBOLD: I really could not offer an opinion on that.

COMMISSIONER HARROLD: Under the conditions in the U.K.?

LORD COBBOLD: Under the conditions in the U.K. I have no doubt about that, and from this point of view: that if the Bank of England were exactly the same animal as the treasury in the sense it recruited the same sort of people and thought from the same angle, there is no point in having two animals. It is much cheaper and more effective to have one animal. The

only advantage you get is that you get primarily a market approach from the central bank, with the governmental considerations in mind, bearing on the official and political approach, and in my experience the fusion of these two and the bearing of one on the other has been extremely useful. If you tried to change the bank into a semi-government department you would lose that benefit, and I think the maintenance of two separate institutions would no longer have a bearing.

COMMISSIONER BROWN: Could I ask one question. If in the circumstances that a difference of opinion does develop, in marshalling your arguments do you consult with the court about this difference of opinion and does your strength vary?

LORD COBBOLD: Very flexible, sir. I again say I should broadly know the mind of members of the court. One would not normally, unless you came to an absolute crisis, consult the court on a formal matter late on Thursday morning. One would largely know the mind of the court. Again, to put it in current terms, if I thought I was running for a first-rate row with the government of the day I should make sure I had the court on my side before I got into that row.

COMMISSIONER LEMAN: Do you visualize the possibility of the governor letting the situation get to the point of having to receive a directive and staying on?

LORD COBBOLD: I would not rule it out.

COMMISSIONER LEMAN: It could be done? It

only advantage you get is that you get primarily a market approach from the central bank, with the government [illegible] in mind, bearing on the official and political approach, and in my experience the fusion of [illegible] extremely useful. If you tried to change the bank into a semi-government department you would lose that benefit, and I think the maintenance of two separate institutions would no longer have a bearing.

COMMISSIONER BROWN: Could I ask one question. If in the circumstances that a difference of opinion does develop, in marshalling your arguments do you consult with the court about this difference of opinion and does your strength vary?

LORD CURBOLD: Very flexible, sir. I again say I should broadly know the mind of members of the court. One would not normally, unless you came to an absolute crisis, consult the court on a formal matter late on Thursday morning. One would largely know the mind of the court. Again, to put it in current terms, if I thought I was running for a first-class row with the government of the day I should make sure I had the court on my side before I got into that row.

COMMISSIONER LEMAN: Do you visualize the possibility of the governor letting the situation get to the point of having to receive a directive and accept it?

LORD CURBOLD: I would not [illegible]

COMMISSIONER LEMAN: It could be done? It

would not make his position impossible?

LORD COBBOLD: No. I could conceive of circumstances in which one would say: "This is what the Bank of England feels, but you gentlemen are ultimately responsible for this, and if you want it done this way for political or more general reasons than we know about, you must take the responsibility for it and give me a direction." That is by no means an inconceivable position.

COMMISSIONER GIBSON: This would be made public?

LORD COBBOLD: Yes.

COMMISSIONER GIBSON: At what point? After the difference had emerged?

LORD COBBOLD: Oh, surely.

COMMISSIONER GIBSON: And the governor required an initial directive?

LORD COBBOLD: There may be legal questions. It has never arisen, and therefore has never been tested. There may be Official Secrets Act questions or something. However, in the position which Mr. Leman suggests I think any givernor would either feel he had to resign or require it be made public he was acting under direction.

COMMISSIONER GIBSON: This would be after he received the directive?

LORD COBBOLD: Oh, certainly.

COMMISSIONER BROWN: Would it be after the new policy had been put into effect?

LORD COBBOLD: I would think certainly. One

would not make his position [illegible]

LORD COBBOLD: No. I could conceive of [illegible]ces in which one would say: "This is what the [illegible] for political or more general reasons than we know about: you must take the responsibility for it and give me a direction." That is by no means an inconceivable position.

COMMISSIONER GIBSON: This would be made public?

LORD COBBOLD: [illegible]

COMMISSIONER GIBSON: At that point? After the difference had emerged?

LORD COBBOLD: Oh, surely.

[illegible] And the governor required an initial directive?

LORD COBBOLD: There may be legal questions. It has never arisen, and therefore has never been tested. There may be Official Secrets Act questions or something. However, in the position which Mr. [illegible] suggests I think any governor would either feel he had to resign or require it be made public he was acting under direction.

COMMISSIONER GIBSON: This would be after he received the directive?

LORD COBBOLD: Oh, [illegible].

COMMISSIONER BROWN: Would it be after the new policy had been put into effect?

LORD COBBOLD: I would think certainly. One

cannot cover all circumstances, but as I envisage that happening it would certainly be afterwards.

COMMISSIONER GIBSON: Do you think the existence of the power to direct means it is very unlikely the power will be used or be necessary?

LORD COBBOLD: As I think I have indicated in my statement, I personally welcome the power to direct. I think it regularizes the position which I believe is the de facto position of the relationship between the government and the bank, and I think it is more convenient and appropriate to have some power of that sort so that you know where you are, and in the sort of circumstances to which Mr. Leman was referring you can put to the public exactly what has happened.

COMMISSIONER GIBSON: Do you think the treasury will make just as much of an effort as formerly to adjust their views?

LORD COBBOLD: That has been the experience, that in the normal give and take between bank and treasury I have not been conscious of any difference before or after. As I think my predecessors made clear, and as I have made clear several times, the view of the bank has been, long before the Bank Act, that in the last resort after a great deal of advice -- Lord Norman used the words "after a lot of nagging" -- the bank recognized it had to follow the policy. It does slightly alter the public status, or could if directions were used frequently. I don't think in fact it has altered the status, and I believe it to be, so far as the Bank of England is concerned, a convenient and proper arrange-

[illegible] all circumstances, but as I envisage that [illegible] would certainly be afterwards.

COMMISSIONER GIBSON: Do you think the existence of the power to direct means it is very unlikely the power will be used or be necessary?

LORD COBBOLD: As I think I have indicated in my statement, I personally welcome the power to direct. I think it regularizes the position which I believe is the de facto position of the relationship between the government and the bank, and I think it is more convenient and appropriate to have some power of that sort so that you know where you are, and in the sort of circumstances to which Mr. Leman was referring you can put to the public exactly what has happened.

COMMISSIONER GIBSON: Do you think the treasury will make just as much of an effort as formerly to [illegible]

LORD COBBOLD: That has been the experience, that in the normal give and take between bank and treasury I have not been conscious of any difference before or after. As I think my predecessors made clear, and as I have made clear several times, the view of the bank has been, long before the Bank Act, that in the last resort after a great deal of advice -- Lord Norman used the words "after a lot of nagging" -- the bank recognized it had to follow the policy. It does still alter the public status, or could if directions were used frequently. I don't think in fact it has altered the status, and I believe it to be, so far as the Bank [illegible] a convenient and proper arrangement.

ment.

COMMISSIONER LEMAN: We talk about these directives rather freely, and this may be a little unfair because it has never been used in England, but if you try to visualize a little more precisely what such a directive would consist of, it would have to be quite preceise because the bank would still have to execute the directive?

LORD COBBOLD: Certainly.

COMMISSIONER LEMAN: If it had to execute something which it inherently felt was quite wrong, and must have felt was wrong because plenty of discussion had taken place, the directive would have to be couched in very precise terms, wouldn't it?

LORD COBBOLD: I believe so.

COMMISSIONER LEMAN: Right down to figures, etc.?

LORD COBBOLD: I would judge so. Really, a direction in those circumstances must come to the treasury taking over the helm.

COMMISSIONER MACKINTOSH: Would it be fair to say aside from recognizing the position of the government that there is need for a less catastrophic way of impasse than the resignation of the governor?

LORD COBBOLD: I believe that is true, yes.

COMMISSIONER MACKINTOSH: That is a way out, and if the occasion, so to speak, is great enough ...?

LORD COBBOLD: Obviously, there must be occasions when the governor thinks it proper to resign, but, as I said previously, I can envisage circumstances

[illegible]

COMMISSIONER [illegible]

[illegible]

[illegible] it has never been used in England, but if you [illegible] to visualize a little more precisely what [illegible] a directive would consist of, it would have to be quite precise because the bank would still have to [illegible] the directive?

LORD COBBOLD: Certainly.

COMMISSIONER LEMAN: If it had to execute something which it inherently felt was quite wrong and must have felt was wrong because plenty of discussion had taken place, the directive would have to be [illegible] in very precise terms, wouldn't it?

[illegible]BOLD: I believe so.

COMMISSIONER LEMAN: Right down to figures, etc.?

LORD COBBOLD: I would judge so. Really, a direction in those circumstances must come to the [illegible] taking over the helm.

[illegible] MACKINTOSH: Would it be fair to say aside from recognizing the position of the government that there is need for a less [illegible] way of impasse than the resignation of the governor?

LORD COBBOLD: I believe that is true, yes.

COMMISSIONER MACKINTOSH: That is a way out, and if the occasion, so to speak, is great enough...?

LORD COBBOLD: Obviously, there may be occasions when the governor thinks it proper to resign, [illegible]

when the governor could within his conscience think his proper duty is to accept a direction on a particular matter and say, "That is their responsibility and not mine." I think if that happened very frequently the governor would be in a very difficult position and probably could not stand up to it; but in isolated instances I have always felt it is a possibility which one could envisage.

COMMISSIONER GIBSON: How far do you think the general public -- an informed public -- should be kept informed about the Bank of England's general views on monetary policy? I take it from what you say there is a good deal of understanding between the bank and the financial community through directions and informal contacts and so on. Do you believe an active effort should also be made by the bank to inform the general public?

LORD COBBOLD: This is a very difficult question indeed, Mr. Gibson. My first answer to the question would be yes; I do believe within limits it is very important, and over the past ten years the Bank of England has been making progressive efforts to try and disseminate views around the country and I, myself, made a number of speeches here and there while in office. We have, of course, a very strong tradition of absolute secrecy lasting over the centuries, and that has to be broken down a little gradually, but we have certainly tried to break it down, and I think it is right to break it down. On the whole we have tended to take the line that if one is in disagreement with the government of

[illegible] could accept [illegible]

his proper duty is to accept a direction on a particular matter and say: "That is their responsibility and not mine." I think if that happened very frequently the [illegible] a very difficult position and probably could not stand up to it; but in isolated instances I have always felt it is a possibility which [illegible].

COMMISSIONER GIBSON: How far do you think the general public -- an informed public -- should be kept informed about the Bank of England's general views on monetary policy? I take it from what you say there is a good deal of understanding between the bank and the financial community through directions and informal contacts and so on. Do you believe an active effort should also be made by the bank to inform the general public?

[illegible]: This is a very difficult question indeed, Mr. Gibson. My first answer to the question would be yes; I do believe within limits it is very important, and over the past ten years the Bank of England has been making progressive efforts to try and disseminate views around the country and I myself made a number of speeches here and there while in office. We have, of course, a very strong tradition of absolute secrecy lasting over the centuries, and that has to be broken down a little gradually, but we have certainly tried to break it down, and I think it is right to [illegible]

[illegible]

[illegible]

the day it is probably better to have that disagreement rather quietly until it is at least near solution or has arrived at solution than to express the bank's views very largely during the course of argument. However, I would not at all say that is always the right view, and again I can perfectly well conceive of circumstances when it would be proper for the bank to let it be known they were not in entire agreement with certain aspects of policy. I think you can only judge on particular occasions and in particular circumstances.

COMMISSIONER GIBSON: Let me put it another way: You see, if you wait until there is an acute disagreement I can see the problem you mention -- the bank making loud statements would create difficulties -- but is there much discussion of monetary policy outside this small group in the city in the I.K.?

LORD COBBOLD: There has always seemed to be at certain times an enormous amount of discussion in many circles, most of which is saying how secretive the Bank of England is and how much better it would be if it would talk a bit more. We have tried to meet that to a certain extent, but our feeling has been that it is something which one needs to go a little gradually with.

COMMISSIONER GIBSON: You have some very good financial journals?

LORD COBBOLD: First rate, and they are in and out of the building all the time and talking to our economic advisers, and so on. There is a very good contact between the bank and the financial press.

COMMISSIONER GIBSON: You feel amongst the

[illegible] way it is probably better to have that disagreement [illegible] until it is at least near solution or has arrived at solution than to express the bank's [illegible]

However, I would not at all say that is always the right view, and again I can perfectly well conceive of circumstances when it would be proper for the bank to let it be known they were not in entire agreement with certain aspects of policy. I think you can only judge on particular occasions and in particular circumstances.

COMMISSIONER GIBSON: Let me put it another way: You see, if you wait until there is an acute disagreement I can see the problem you mention -- the bank making loud statements would create difficulties -- but is there much discussion of monetary policy outside this small group in the city in the U.K.?

LORD COBBOLD: There has always seemed to be at certain times an enormous amount of discussion in many circles, most of which is saying how secretive the Bank of England is and how much better it would be if it would talk a bit more. We have tried to meet that to a certain extent, but our feeling has been that it is something which one needs to go a little gradually with.

COMMISSIONER GIBSON: You have some very good financial journalists?

LORD COBBOLD: First rate, and they are in and out of the building all the time and talking to our economic advisers, and so on. There is a very good contact between the bank and the financial press.

COMMISSIONER GIBSON: You feel amongst the

public that are interested there is a fairly continuous discussion and interest in monetary matters?

LORD COBBOLD: Pretty wide and increasing all the time.

COMMISSIONER HARROLD: These speeches you mentioned: Has that been the practice of former governors as well?

LORD COBBOLD: No, I rather did a good deal more of that than my predecessors did.

COMMISSIONER HARROLD: This was with the concurrence of the court?

LORD COBBOLD: Concurrence and encouragement. Of course, the court help in that a great deal because they are moving about at high level in very varied circles, and people talk to them over lunch and at social gatherings, and so on, and they are able to do a good deal of helping with the general discussions of the sort of things which are occupying the bank's thoughts at the time.

THE CHAIRMAN: You may have covered this point and I haven't recollected it: What is the term of office of the governor -- or, is there a definite term?

LORD COBBOLD: Five years for governor and deputy governor; four years for directors, renewable.

---SHORT RECESS

THE CHAIRMAN: We will now resume. Mr. Brown has some additional questions which he would like to ask.

COMMISSIONER BROWN: Mr. Chairman, I would like to go back just a little bit to the first discussions you were having and ask a supplementary question on the executive directors of the bank. Lord Cobbold mentioned that this gave them increased stature outside the bank and in the court, and I wonder if he would mind telling us whether this made a difference in their relationships with him personally?

LORD COBBOLD: You mean is the degree of importance one would attach to what he is saying in discussions?

COMMISSIONER BROWN: And their freedom to give you advice on their own rather than looking just to yourself.

LORD COBBOLD: Yes, I would think it does; certainly it is an additional status, and he, after all, becomes a colleague as a member of the board of directors and court of directors, and perhaps feels more free to press his views, than an official, however senior. I think I did mention that it also enables him to speak on equal terms with part-time directors of the court, which is another very important aspect of it. But, I think if the governor and deputy governor found themselves hotly opposed by executive directors on a particular issue, they would certainly think very carefully before they took that any further;

THE CHAIRMAN: We will now resume. Mr. Brown has some additional questions which he would like to ask.

COMMISSIONER BROWN: Mr. Chairman, I would like to go back just a little bit to the first discussions you were having and ask a supplementary question on the executive directors of the bank. Lord Cobbold mentioned that this gave them increased stature outside the bank and in the court, and I wonder if he would mind telling us whether this made a difference in their relationships with him personally?

LORD COBBOLD: You mean in the degree of importance one would attach to what he is saying in discussions?

COMMISSIONER BROWN: And their freedom to give you advice on their own rather than looking just to yourself.

LORD COBBOLD: Yes, I would think it does; certainly it is an additional status, and he, after all, becomes a colleague as a member of the board of directors and court of directors, and perhaps feels more free to press his views, than an official, however senior. I think I did mention that it also enables him to speak on equal terms with part-time directors of the court, which is another very important aspect of it. But, I think if the governor and deputy governor found themselves hotly opposed by executive directors on a particular issue, they would certainly think very carefully before they took that

they would certainly attach -- perhaps just that little more weight and status to anybody who is a member of the court.

COMMISSIONER BROWN: Thank you very much. The other question I would like to ask, and this is on the question of the directors, the part-time directors, you mentioned that you had representatives from banks, finance, shipping and the trade unions. I assume that this has been found to be very useful and practical?

LORD COBBOLD: Yes indeed. I think that all the people we have had from the trade unions -- I would like again to say that they are not representatives in the sense that they are appointed by any particular party; it is Mr. X who happens to be a prominent person in the trade union field. He is not, so to speak, there representing the T.U.C. in the formal sense. They have been extremely helpful in the last four or five years under my governorship. We had one of the people who came from that circle on the committee of treasury and he was a most valuable member of the team.

COMMISSIONER BROWN: Thank you very much.

COMMISSIONER GIBSON: One supplementary question, sir; you stated in your initial statement that the part-time directors -- indeed, all the directors -- were appointed on the advice of the government of the day, on the government's suggestion.

LORD COBBOLD: Formally appointed by the Queen in a constitutional form, which means on the

[illegible] -- [illegible]

[illegible]

[illegible]

COMMISSIONER [illegible]: [illegible]

The other question I would like to ask, and this is [illegible] directors, you mentioned that you had representatives from banks, finance, shipping and the trade unions. I assume that this has been found to be very useful and practical?

LORD CORBETT: Yes indeed. I think that all the people we have had from the trade unions -- I would like again to say that they are not representatives in the sense that they are appointed by any particular party; it is Mr. X who happens to be a prominent person in the trade union field. He is not, so to speak, there representing the T.U.C. in the formal sense. They have been extremely helpful in the last four or five years under my governorship. We had one of the people who came from that circle on the committee of treasury and he was a most valuable member of the team.

COMMISSIONER BROWN: Thank you very much.

COMMISSIONER GIBSON: One supplementary question, sir; you stated in your initial statement that the part-time directors -- indeed, all the directors -- were appointed on the advice of the [illegible]

LORD [illegible]: [illegible]

The Queen in a constitutional form, which means on the

advice of the Prime Minister.

COMMISSIONER GIBSON: I was wondering how the suggestion came up as to who would be appointed?

LORD COBBOLD: The Prime Minister and the Chancellor of the day have been good enough to consult the governor on every occasion on appointment or re-appointment.

THE CHAIRMAN: Then we come to point three; relations between the Bank of England and banks and other financial institutions of the United Kingdom. Would you like to restate --

LORD COBBOLD: Perhaps I might make a few introductory remarks on that. There again I would stress very much the geographical advantage that we have in London over many other financial centres. There is, as you are aware, a very high degree of centralization of boards of directors and general management of the leading financial institutions in London and, in fact, in the city of London, and it really is no exageration to say if the Governor of the Bank of England wishes to consult with the leading representatives of the financial community in the United Kingdom -- banking, insurance, investment trust, stock exchange and a good deal of commercial as well -- he can in fact get them all in his room in half an hour and that, of course, does make a very great difference and I very often, in speaking particularly in the United States, pointed out the difference of Mr. Martin's problem and my own problem at the time.

[illegible]

COMMISSIONER [illegible]: I was [illegible]

the suggestion came up as to who would be appointed?

LORD COBBOLD: [illegible]

the Chancellor of the day have been good enough to consult the governor on every occasion on appointment or re-appointment.

THE CHAIRMAN: Then we come to point three; relations between the Bank of England and banks and other financial institutions of the United Kingdom. Would you like to restate --

LORD COBBOLD: Perhaps I might make a few introductory remarks on that. There again I would stress very much the geographical advantage that we have in London over many other financial centres. There is, as you are aware, a very high degree of centralization of boards of directors and general management of the leading financial institutions in London and, in fact, in the city of London, and it really is no exaggeration to say if the Governor of the Bank of England wishes to consult with the leading representatives of the financial community in the United Kingdom -- banking, insurance, investment trusts, stock exchange and a good deal of commercial as well -- he can in fact get them all in his room in half an hour and that, of course, does make a very great difference and I very often, in speaking [illegible] in the United States, pointed out the [illegible]ence of Mr. Martin's problem and my own problem [illegible] time.

If he endeavoured to get a joint opinion from the United States banking community, he probably would have to have 10,000 people there and many of them probably would have to travel several thousand miles, and it is a very different proposition, and I think it is extremely important to bear that in mind in considering how the London arrangements might affect, or be translated into terms of arrangements particularly on this continent.

It is extremely important in being able to get people into one's room; the heads of all the banks, the heads of most of the insurance companies, and the stock exchange, and so on, but in many ways, I would judge it even more important because it means that, if you like, socially, or in meeting on the street, or in travelling up and down, or luncheon in the city or in the evenings, the central bank people are always meeting the leaders in the commercial banks and the leading insurance and finance companies. not only at top levels, but further down as well, so that there is a natural and easy exchange of ideas and thought.

We have always encouraged our senior people, for example, to lunch around the city with the large banks and insurance companies so that they get to know their opposite members, and although I don't say they discuss detailed issues on these sort of occasions, it does mean there is a continual interchange and the people in the commercial banks always know pretty intimately the people who are running the

foreign exchanges or the internal market, and I think they feel that way, that they are not so far apart and that there is less of an ivory tower than they would feel if that easy contact were not available.

I stress this because I think this is very important in the way that our institutions have grown up, and again I very fully recognize that that is far more difficult in a country like this, of this size, with your provincial divisions and so on. But as far as the London organization is concerned, it certainly is extremely important.

Passing in rather more detail to relationships with the various parts of the market, by far the most important, of course, is the relationship between the Bank of England and the clearing banks. There are, as you know, eleven clearing banks -- what we call the "Big Five" -- and then six others; they control the bulk of the deposit banking business together with the Scottish and Northern Irish banks, which I will refer to in a minute. By far our most important contact is with the clearing bank system. I think this is so important that it would be worthwhile just repeating what I said to the Radcliffe committee on that subject, if I may.

So far as the clearing banks are concerned, there is a regular quarterly meeting between the governors and the chairmen of the clearing banks, with the governor or deputy governor in the chair. The Committee of London Clearing Bankers meet every month by themselves, and under these arrangements once

[illegible] or the internal market, and I think [illegible] that way, that they are not so far apart. [illegible] there is less of an ivory tower than they would feel if that easy contact were not available.

I stress this because I think this is very important in the way that our institutions have grown up, and again I very fully recognize that that is far more difficult in a country like this, of this size, with your provincial divisions and so on. But as far as the London organization is concerned, it certainly is extremely important.

Passing in rather more detail to relationships with the various parts of the market, by far the most important, of course, is the relationship between the Bank of England and the clearing banks. There are, as you know, eleven clearing banks -- what we call the "Big Five" -- and then six others; they control the bulk of the deposit banking business [illegible] which I will refer to in a minute. By far the [illegible] system. I think this is so important that it would be worthwhile just repeating what I said to the Radcliffe committee on that subject, if I may.

So far as the clearing banks are concerned, there is a regular quarterly meeting between the governors and the chairmen of the clearing banks, [illegible]h the governor or deputy governor in the chair. The Committee of London Clearing Bankers meet every month by themselves, and under these arrangements once

a quarter they meet at the Bank of England. From time to time, if there is anything of sufficient importance to warrant it, the governor attends one of the other monthly meetings, or on occasion there is a special ad hoc meeting at the Bank of England with the members of the Committee of London Clearing Bankers, which represent the eleven clearing banks, but the main contact is between the governor and the deputy governor on the one hand and the chairman and the deputy chairman of the Clearing Bankers Committee on the other. I could not say exactly how often we meet, but I should think once or twice a week on the average, less when there is nothing of particular interest to discuss, and, of course, very much more when there is any particular issue. But whether or not there are particular issues, the governor has always made a point of regular meetings with the chairman of the Clearing Banks Committee to keep a close contact and make sure if snything is arising that it is discussed between them.

On the whole, both parties have found it more convenient to deal with it in this way, through the chairman of the Clearing Banks Committee and the governor and deputy governor, rather than to have the full meeting of the Committee on each occasion. That is the contact at top level.

Then there is regular contact between the Chief Cashier, who is the senior operating official of the bank, and the chairman and the deputy chairman and the Chief Executive Officers' Committee, which is

[illegible]er they meet at the Bank of England. From time to time, if there is anything of sufficient importance to warrant it, the governor attends one of the other monthly meetings, or on occasion there is a special _ad hoc_ meeting at the Bank of England with the members of the Committee of London Clearing Bankers, which represent the eleven clearing banks, but the main contact is between the governor and the deputy governor on the one hand and the chairman and the deputy chairman of the Clearing Bankers Committee on the other. I could not say exactly how often we meet, but I should think once or twice a week on the average, less when there is nothing of particular interest to discuss, and, of course, very much more when there is any particular issue. But whether or not there are particular issues, the governor has always made a point of regular meetings with the chairman of the Clearing Banks Committee to keep a close contact and make sure if anything is arising that it is discussed between them.

On the whole, both parties have found it more convenient to deal with it in this way, through the chairman of the Clearing Banks Committee and the governor and deputy governor, rather than to have the full meeting of the Committee on each occasion. That is the contact at top level.

Then there is regular contact between the Chief Cashier, who is the senior operating official [illegible]
and the Chief Executive Officers' Committee, which is

the operating committee for the Committee of London Clearing Bankers.

There are also, of course, a lot of contacts with individual clearing banks on matters which affect the individual bank rather than the banking community as a whole. Very often one of the chairmen or one of the chief officers comes in to see the governor or the chief cashier either on matters affecting that particular bank and sometimes on matters of more general interest. On top of that there is the day-to-day routine contact in the money market between our discount office and the clearing banks' money departments, and on the Overseas side between our exchange offices and the clearing banks' Overseas offices. I think there is a continual link and contact on market matters going on all the time as well as a link on policy or more general matters. That, as I say, is the most important contact in the city.

We also have a very close contact with the accepting houses, with the Accepting Houses Committee and with the individual houses and, as has already been referred to, there are several directors of the bank who came from the accepting houses.

Then, we keep in touch, too, with the Scottish and Northern Irish banks; we always are at pains to keep them informed and in discussion on any general change of policy. There is a Scottish and Northern Irish Banks Committee and we deal direct with them, although in many cases there are direct links between the Scottish and Northern Irish banks and

the operating committee for the [illegible] Clearing [illegible].

There are also, of course, a lot of contacts with individual clearing banks on matters which affect the individual bank rather than the banking community as a whole. Very often one of the chairmen or one of the chief officers comes in to see the Governor or the chief cashier either on matters affecting that particular bank and sometimes on matters of more general interest. On top of that there is the day-to-day routine contact in the money market between our discount office and the clearing banks' money departments and on the Overseas side between our exchange office and the clearing banks' Overseas offices. I think there is a continual link and contact on market matters going on all the time as well as a link on policy or more general matters. That, as I say, is the most important contact in the city.

We also have a very close contact with the accepting houses, with the Accepting Houses Committee and with the individual houses and, as has already been referred to, there are several directors of the Bank who come from the accepting houses.

Then, we keep in touch, too, with the Scottish and Northern Irish banks; we always are at pains to keep them informed and in discussion on any general issues of policy. There is a Scottish and Northern Irish Banks Committee and we deal direct with them, although in many cases there are direct links between the Scottish and Northern Irish banks and

the London clearing banks.

Apart from the banking system, we have a close relationship with various other sections of the financial market. Take the Stock Exchange Committee, for example; the governor would arrange to see the chairman of the Stock Exchange probably once in a week or once in two weeks, or more frequently if there were any particular matter under discussion; with the insurance companies who have representative committees, the issuing houses, the trust companies, and the investment companies. The last named perhaps a little less frequently than with the banks, accepting houses, stock exchange and the insurance companies.

The relationships with the banking system and control of credit generally have -- as I think the Commission will be aware -- been exercised in England since the war by what I have called a conscious mixture of informal requests and persuasion, together with monetary weapons such as bank rate, open market operations and, more latterly, special deposits and largely for the reasons which I gave in my initial opening statement that there has always been a tradition of close co-operation and I think the preference of the London banking system to work on the basis of unwritten law and on the basis of having a word with The Bank of England rather than waiting to have official and formal directions and that tradition has, to a very large extent, continued and it is the normal and accepted practice that the governor in nine cases

[illegible]

Apart from the banking system, we have a close relationship with various other sections of the financial market. Take the Stock Exchange Committee, for example, [illegible] chairman of the Stock Exchange probably once in a week or once in two weeks, or more frequently if there were any particular matter under discussion; with the insurance companies who have representative committees, the issuing houses, the trust companies, and the investment companies. The last named perhaps a little less frequently than with the banks, accepting houses, stock exchange and the insurance companies.

The relationships with the banking system and control of credit generally have -- as I think the Commission will be aware -- been exercised in England since the war by what I have called a curious mixture of informal requests and persuasion, together with monetary weapons such as bank rate, open market operations and, more latterly, special deposits and largely for the reasons which I gave in my initial opening statement that there has always been a tradition of close co-operation and I think the preference of the London banking system to work on the basis of unwritten law and on the basis of having a word with The Bank of England rather than waiting to have official and formal directions and that tradition has, to a very large extent, continued and it is the normal [illegible]

out of ten after discussion with the Chancellor of the Exchequor and the Treasury should indicate the Bank's wishes, which are often the combined wishes of the bank and government and that they could indicate them privately through the chairman of the Clearing Bank Committee and the other committees, rather than issue any sort of formal directive, and it has always been accepted that views conveyed in that rather informal way have much the same force as a more formal direction.

We have found that useful because it enables us -- before always saying what we want, we have the opportunity of informal discussion with representatives of the banks, and they have often put it to us that it would be easier for them to do it in a slightly different way and reach the same result, and we have been able to make an adjustment here and there which would be not possible if these requests were conveyed in a more formal method.

out of ten after discussion with the Chancellor of the Exchequer and the Treasury should indicate the Bank's wishes, which are often the combined wishes of the bank and government and that they could indicate them privately through the chairman of the Clearing Bank Committee and the other committees, rather than issue any sort of formal directive, and it has always been accepted that views conveyed in that rather informal way have much the same force as a more formal direction.

We have found that useful because it enables us -- before always saying what we want, we have the opportunity of informal discussion with representatives of the banks, and they have often put it to us that it would be easier for them to do it in a slightly different way and reach the same result, and we have been able to make an adjustment here and there which would be not possible if these requests were conveyed in a more formal method.

The greatest difficulty, I think, that we have run up against in the past few years -- to some extent right from the end of the war, but it is growing all the time -- is this question of what are usually called near banks; that is to say, those institutions that do not come within any of the categories of clearing banks, accepting houses, or issuing houses, but which take deposits and lend money in one way or another in direct or indirect competition with the clearing banks. This has become an extremely difficult subject, and, frankly, I am bound to say that we have not reached any sort of a solution to this difficulty in the United Kingdom. I think the same difficulty exists in many other markets around the world, and it is a problem which, certainly in my time, has engaged a great deal of thought and time of central bank governors, and I would guess it is still doing so. My own feeling is that there will probably have to be some new legislation or, at any rate, some new arrangements in the United Kingdom in order to try to cover this very intractable subject.

Obviously, the clearing banks and the accepting houses, and those that are covered by these requests or special deposit arrangements, increasingly find it irritating that they have to conform with requests or directions which frequently mean losing business, and there is a tendency for that business to be taken over by people who are outside those categories and who are not subject to either formal

[illegible]

[illegible] have run up against in the past few years -- to some extent right from the end of the war, but it is growing all the time -- is this question of what are usually called near banks: that is to say, those institutions that do not come within any of the categories of clearing banks, accepting houses, or issuing houses, but which take deposits and lend money in one way or another in direct or indirect competition with the clearing banks. This has become an extremely difficult subject, and, frankly, I am bound to say that we have not reached any sort of a solution to this difficulty in the United Kingdom. I think the same difficulty exists in many other markets around the world, and it is a problem which, certainly in my time, has engaged a great deal of thought and time of central bank governors, and I would guess it is still doing so. My own feeling is that there will probably have to be some new legislation or, at any rate, some new arrangements in the United Kingdom in order to try to cover this very interesting [illegible]

Obviously, the clearing banks and the accepting houses, and those that are covered by these requests or special deposit arrangements, increasingly find it irritating that they have to conform with requests or directions which frequently mean losing business, and there is a tendency for that business to be taken over by people who are outside those categories and who are not subject to either formal

or informal discipline by the central authority.

I would not like to go so far as to say the relationships were strained at all, but I think it would be fair to say that the banking community that is, the clearing banks, the accepting houses, and the other members of the regular categories -- is finding it increasingly difficult and unfair that they should be asked from time to time to conform to reduce lending and to have the special deposit arrangements applied to some of them, and at the same time to see a good deal of business which they might otherwise have done pass into other channels.

So far as the United Kingdom is concerned, I can only say that that is something that is being studied very actively. I think my successor and his colleagues are extremely conscious of the difficulties that this situation presents, and that we are by no means at the end of that story.

I think that is about all I have to say.

COMMISSIONER HARROLD: Lord Cobbold, you are conscious of the geographic situation as between the Canadian central bank and the United Kingdom central bank. If you were faced with a somewhat similar situation in the United Kingdom, would you feel that a strong branch system would overcome some of the difficulties?

LORD COBBOLD: I do not think it would nearly meet the same thing that I am talking about. I think it would help in some degree. Of course, the

or informal discipline by the central authority.

I would not like to go so far as to say the relationships were strained at all, but I think it would be fair to say that the banking community that is, the clearing banks, the accepting houses, and the other members of the regular categories -- is finding it increasingly difficult and unfair that they should be asked from time to time to conform to reduce lending and to have the special deposit arrangements applied to some of them, and at the same time to see a good deal of business which they might otherwise have done pass into other channels.

So far as the United Kingdom is concerned, I can only say that that is something that is being studied very actively. I think my successor and his colleagues are extremely conscious of the difficulties that this situation presents, and that we are by no means at the end of that story.

I think that is about all I have to say.

[illegible]

you are conscious of the geographic situation as between the Canadian central bank and the United Kingdom central bank. If you were faced with a somewhat similar situation in the United Kingdom, would you feel that a strong branch system would overcome some of the difficulties?

LORD COBBOLD: I do not think it would really meet the same thing that I am talking about. I think it would help in some degree. Of course, the

advantage we have is that we can meet with the top people and the responsible people easily and regularly.

COMMISSIONER HARROLD: As an operator of a central bank you would see some difficulty in the branch system trying to take on this sort of an operation?

LORD COBBOLD: I would only say so if it is the top people who can get together all the time. If you have the top people going around, so to speak, and basing themselves on branches, it could be helpful.

I do not know whether this is a helpful comment, but we do that in the United Kingdom in a very minor degree. We have small branches in most of the big provincial cities in England, and it has always been our practice for an executive director to go around pretty regularly and sit in the branch for a couple of days or so, and make sure of meeting the business community and the financial community in that district. While I was the governor I made it a point of going around myself once a year, perhaps, to most of those centres, and having lunch or dinner and a talk afterwards with the leaders in those places.

COMMISSIONER HARROLD: You also mentioned the Scottish and Northern Ireland banks and committees. Would these committees be located in London?

LORD COBBOLD: No, in Edinburgh and Belfast.

COMMISSIONER HARROLD: And you were able to

advantage we have is that we can meet with the top people and the responsible people easily and regularly.

COMMISSIONER HARROLD: As an operator of a central bank you would see some difficulty in the branch system trying to take on this sort of an operation?

LORD COBBOLD: I would only say so if it is the top people who can get together all the time. If you have the top people going around, so to speak, and basing themselves on branches, it could be helpful.

I do not know whether this is a helpful comment, but we do that in the United Kingdom in a very minor degree. We have small branches in most of the big provincial cities in England, and it has always been our practice for an executive director to go around pretty regularly and sit in the branch for a couple of days or so, and make sure of meeting the business community and the financial community in that district. While I was the governor I made it a point of going around myself once a year, perhaps, to most of those centres, and having lunch or dinner and a talk afterwards with the leaders in those places.

[illegible] the Scottish and Northern Ireland banks and committees. Would these committees be located in London?

[illegible]

COMMISSIONER HARROLD: And you were able to

get some kind of a contact that was satisfactory?

LORD COBBOLD: Yes. They come down, of course, to London pretty often because the chairmanship rotates between the leading Scottish banks, and the chairman of the Scottish banks committee tends to be in London at least once a month, and perhaps more often. Very often he would drop into the bank, and if the Bank of England had anything important we would send up a director or a senior official to Edinburgh to discuss things with them in the same way as we would discuss things with the Committee of London Clearing Bankers. But, as I say, the majority of the Scottish banks have very close contacts with, or are owned or partly owned by, the London banks. In one case it is the Scottish bank that owns, or mainly owns, the London Clearing Bank.

COMMISSIONER HARROLD: I have heard it said at one time or another that one of Scotland's main exports to London is bank managers.

LORD COBBOLD: I should think it is about equal to their export of bank managers to other parts of the Commonwealth.

COMMISSIONER GIBSON: May I ask you a question about the meetings between the clearing bankers and the Bank of England. Are these meetings fairly informal in their character?

LORD COBBOLD: I would say that on the whole the quarterly meetings between the governors and the chairmen tend to be rather formal, although on occasions I have known a subject to be discussed

get some kind of a contact that was satisfactory?

LORD COBBOLD: Yes. They come down, of course, to London pretty often because the chairmanship rotates between the leading Scottish banks, and the chairman of the Scottish banks committee tends to be in London at least once a month, and perhaps more often. Very often he would drop into the bank, and if the Bank of England had anything important we would send up a director or a senior official to Edinburgh to discuss things with them in the same way as we would discuss things with the Committee of London Clearing Bankers. But, as I say, the majority of the Scottish banks have very close contacts with, or are owned or partly owned by, the London banks. In one case it is the Scottish bank that owns, or mainly owns, the London Clearing Bank.

COMMISSIONER HAROLD: I have heard it said at one time or another that one of Scotland's main exports to London is bank managers.

LORD COBBOLD: I should think it is about equal to their export of bank managers to other parts of the Commonwealth.

COMMISSIONER GIBSON: May I ask you a question about the meetings between the clearing bankers and the Bank of England. Are these meetings fairly informal in their character?

LORD COBBOLD: I would say that on the whole the quarterly meetings between the governors and the chairmen tend to be rather formal, although on occasions I have known a subject to be discussed

pretty informally. However, the quarterly meetings are mainly formal.

If there is a subject which requires more informal discussion, it would be discussed between the governor and the chairman personally who, as I said, have frequent informal discussions ranging over a wide field with either party free to bring up anything he wanted to bring up. On a number of occasions I have know of ad hoc meetings of the committee to discuss a particular subject of urgent interest, and then they would tend to be rather less formal.

The governor would also normally take the opportunity of the quarterly meetings to talk for ten minutes or a quarter of an hour when he would give a general picture of his view of the situation at the time.

COMMISSIONER GIBSON: That leads to my next question. Are the subjects of discussion usually technical matters concerning the use of the Bank of England, about the market or banking arrangements, or do you range over the broad field of economic policy?

LORD COBBOLD: As I was saying, I would always take the opportunity of a quarterly meeting to range a little widely over everything that I thought ought to be in the minds of the chairmen of the clearing banks.

COMMISSIONER GIBSON: You would talk about the trend of business and exchange problems?

LORD COBBOLD: Yes. I would even, for example, say that in our opinion employment is falling down a little, or that it looks a little uppish, and I would go around the table to see whether anybody had a different opinion or whether those opinions on a rather general matter were confirmed. If we were discussing some particular transaction or section of the market, then that would tend to be done between the chief cashier and the chief executive officers.

COMMISSIONER GIBSON: So the meetings do discuss the general financial atmosphere to quite a large extent?

LORD COBBOLD: Yes. I would not say that those meetings would discuss policy as such, or what we were going to do about anything. That would not be normal. Those meetings more normally would discuss some particular thing that was bothering the banks and that they would raise with the governor. For example, this question of near banks has often been raised at those meetings.

The main discussion of economic problems would, as I say, result from the short survey which the governor would normally give, and he would then largely be taking the opportunity of seeing whether anybody had any comment on this general view of the situation, or the Bank's general view of the situation, or whether the banks were by and large in agreement.

We also have an arrangement by which from time to time, when we see a change in the economy in one direction or another, I would ask

LORD COBBOLD: Yes. I would even, for example, say that in our opinion employment is falling down a little, or that it looks a little uppish, and I would go around the table to see whether anybody had a different opinion or whether those opinions on a rather general matter were confirmed. If we were discussing some particular transaction or section of the market, then that would tend to be done between the chief cashier and the chief executive officers.

COMMISSIONER GIBSON: So the meetings do discuss the general financial atmosphere to quite a large extent?

LORD COBBOLD: Yes. I would not say that those meetings would discuss policy as such, or what we were going to do about anything. That would not be normal. Those meetings more normally would discuss some particular thing that was bothering the banks and that they would raise with the governor. For example, this question of near banks has often been raised at those meetings.

The main discussion of economic problems would, as I say, result from the short survey which the governor would normally give, and he would then largely be taking the opportunity of seeing whether anybody had any comment on this general view of the situation, or the Bank's general view of the situation, or whether the banks were by and large in agreement.

We also have an arrangement by which from time to time, when we see a change in the economy in one direction or another, I would ask

the chairman of the Clearing Banks Committee to arrange for all the clearing banks to collect from their branches and process at their head offices a general survey of the situation and send it into us as of June 30, or whatever date it might be. This is not a regular arrangement because we have always felt that regular returns tend to lose a little bit and become routine things, but we have very often found, when there was a change in the situation, that it was useful to gather a general report from all the clearing banks, and the Scottish banks as well, and get that processed by the Committee of London Clearing Banks and sent in to us. That would, of course, be supported by the very frequent discussions between the governor and the chairman of the clearing banks committee.

COMMISSIONER GIBSON: You might telephone him any day or he might drop in to see you at any time?

LORD COBBOLD: Yes, we very frequently do that.

COMMISSIONER GIBSON: And you might talk about another subject? Your talks would not be held to any narrow field?

LORD COBBOLD: We might talk about any subject. Very frequently he would telephone me and say: "If you have five minutes I would like to look in". In times that were difficult, I think that that might happen two or three times a week, and the chairmen of the other clearing banks might do it as well if they

the chairman of the Clearing Banks Committee to arrange for all the clearing banks to collect from their branches and process at their head offices a general survey of the situation and send it into us as of June 30, or whatever date it might be. This is not a regular arrangement because we have always felt that regular returns tend to lose a little bit and become routine things, but we have very often found, when there was a change in the situation, that it was useful to gather a general report from all the clearing banks, and the Scottish banks as well, and get that processed by the Committee of London Clearing Banks and sent in to us. That would, of course, be supported by the very frequent discussions between the governor and the chairman of the clearing banks committee.

COMMISSIONER GIBSON: You might telephone him any day or he might drop in to see you at any time.

LORD COBBOLD: Yes, we very frequently do that.

COMMISSIONER GIBSON: And you might talk about another subject? Your talks would not be held to any narrow field?

LORD COBBOLD: We might talk about any subject. Very frequently he would telephone me and say: "If you have five minutes I would like to look in". In times that were difficult, I think that that might happen two or three times a week, and the chairman of the other clearing banks might do it as well if they

had anything on which they particularly wanted the Bank of England's action. If they had something which they thought we ought to know about they would come over and have a chat.

COMMISSIONER GIBSON: Do you feel they were very forthcoming in expressing their opinions to you?

LORD COBBOLD: Very.

COMMISSIONER GIBSON: They were not at all reserved?

LORD COBBOLD: No, I found very little reserve on the subject.

COMMISSIONER BROWN: Are there channels between yourself and the chairmen of the foreign banks in London -- that is, the Commonwealth and foreign banks?

LORD COBBOLD: On any major move we would see the chairmen of a number of committees. There is the chairman of the committee of American banks, and a number of committees of overseas banks -- I think there are four in all. When we are issuing any regulation or directive we would see the chairmen of those committees as well as the British banks.

COMMISSIONER BROWN: Do you find the same degree of co-operation on the moral suasion issues?

LORD COBBOLD: Yes, they have behaved extraordinarily well.

COMMISSIONER BROWN: Do you have any contact or discussions with the issuing houses or the stock exchanges when a new government issue is

had anything on which they particularly wanted the Bank of England's action. If they had something which they thought we ought to know about they would come over and have a chat.

COMMISSIONER GIBSON: Do you feel they were very forthcoming in expressing their opinions to you?

LORD COBBOLD: Very.

COMMISSIONER GIBSON: They were not at all reserved?

LORD COBBOLD: No, I found very little reserve on the subject.

[illegible]: Are there [illegible] between yourself and the chairmen of the foreign banks in London -- that is, the Commonwealth and [illegible]?

LORD COBBOLD: On any major move we would see the chairmen of a number of committees. There is the chairman of the committee of American banks, and a number of committees of overseas banks -- I think there are four in all. When we are issuing any regulation or directive we would see the chairmen of those committees as well as the British banks.

COMMISSIONER BROWN: Do you find the same degree of co-operation on the moral suasion issues?

LORD COBBOLD: Yes, they have behaved extraordinarily well.

COMMISSIONER BROWN: Do you have any contact or discussions with the issuing houses or the stock exchanges when a new government issue is

under discussion?

LORD COBBOLD: I would hardly say there is discussion with the stock exchange. We work, of course, through the government broker so far as the stock exchange is concerned, and our officials would have a great number of discussions with the government broker, and we would look to him to reflect stock exchange opinion and to advise us on stock exchange conditions and stock exchange terms. Then, again, the stock exchange is just over the road, and many of our senior officials would be pretty well informed about what a lot of people over the road were thinking at any particular time. There is a geographic question which comes in again there.

COMMISSIONER BROWN: Does he inform you of the feeling on the floor of the exchange?

LORD COBBOLD: To some extent, but when we are dealing with the government broker he advises us as precisely as any head broker would advise any bank. Of course, the fixing of terms of a new government issue is a matter for government, but it is very largely guided by the Bank of England's advice. We handle all the practical and operating side of those transactions. The procedure would be that there would be many initial discussions between the chief cashier and our operating officials and the government broker's people, who would work the thing up to a certain pitch. It would then come up to the

[illegible]

LORD COBBOLD: I would hardly say there is discussion with the stock exchange. We work, of course, through the government broker so far as the stock exchange is concerned, and our officials would have a great number of discussions with the government broker, and we would look to him to reflect stock exchange opinion and to advise us on stock exchange conditions and stock exchange terms. Then, again, the stock exchange is just over the road, and many of our senior officials would be pretty well informed about what a lot of people over the road were thinking at any particular time. There is a geographic question which comes in again there.

COMMISSIONER BROWN: Does he inform you of the feeling on the floor of the exchange?

LORD COBBOLD: To some extent, but when we are dealing with the government broker he advises us as precisely as any head broker would advise any bank. Of course, the fixing of terms of a new government issue is a matter for government, but it is very largely guided by the Bank of England's advice. We handle all the practical and operating side of those transactions. The procedure would be that there would be many initial discussions between the chief cashier [illegible] broker's people, who would work the thing up to a certain pitch. It would then come up to the

governor's level and when a decision was near being reached the governor would have a talk, or perhaps two or three talks, with the government broker before making a recommendation to government.

COMMISSIONER MACKINTOSH: May I ask a question here? You spoke of the concern that the Bank of England felt in respect of the near banks?

LORD COBBOLD: Yes.

COMMISSIONER MACKINTOSH: Is the hesitation here a matter of being unwilling to take the step of bringing these groups within the banking system, or is it occasioned by the technical difficulties that --

LORD COBBOLD: I am afraid I am a bit behind-hand on this because this matter may have moved since I had anything to do with it. When I had to do with it it was solely on the technical and legal side of drafting where enormous difficulties seemed to present themselves. There was difficulty about the definition of a bank and as to how you would bring them in. It was a difficulty in drafting any statutory clauses which would affect the different types of near banks. They were all technical legal and drafting difficulties. I think everybody recognizes that something needs to be done about this problem, but, as I say, whether that has moved a further stage in recent months, I am afraid I could not say. I do know that my successor and others still feel it is a very awkward proposition, and that it has not yet been adequately covered.

THE CHAIRMAN: Aside from the difficulty

governor's level and when a decision was near being reached the governor would have a talk, or perhaps two or three talks with the government broker before making a recommendation to government.

COMMISSIONER MACKINTOSH: May I ask a question here? You spoke of the concern that the Bank of England felt in respect of the near banks?

LORD COBBOLD: Yes.

COMMISSIONER MACKINTOSH: Is the hesitation here a matter of being unwilling to take the step of bringing these groups within the banking system, or is it occasioned by the technical difficulties that --

LORD COBBOLD: I am afraid I am a bit behind-hand on this because this matter may have moved since I had anything to do with it. When I had to do with it it was solely on the technical and legal side of drafting where enormous difficulties seemed to present themselves. There was difficulty about the definition of a bank and as to how you would bring them in. It was a difficulty in drafting any statutory clauses which would affect the different types of near banks. They were all technical legal and drafting difficulties. [illegible] recognizes that something needs to be done about this problem, but, as I say, whether that has moved a further stage in recent months, I am afraid I could not say. I do know that my successor and others still feel it is a very awkward proposition, and that it has not yet been adequately covered.

THE CHAIRMAN: Aside from the difficulty

of drafting was any policy more or less decided upon, generally, so as to deal with the situation?

LORD COBBOLD: No, I would say it had not been. The first difficulty is in the question of defining banks, and seeing who could be brought under various types of umbrella. Nobody has yet devised a method of --

THE CHAIRMAN: We have had a variety of definitions of things given us. I do not know whether you have another one.

LORD COBBOLD: I think, actually, our main definition is that a bank is anybody who the Bank of England, with the approval of the treasury, says is a bank.

COMMISSIONER GIBSON: In your thinking about it, Lord Cobbold, what are the main considerations? Would they centre around the nature of the deposits and the rate of turnover? Are those factors in your thinking?

LORD COBBOLD: In thinking about near banks?

COMMISSIONER GIBSON: Yes.

LORD COBBOLD: Yes, I have been thinking on both the deposit side and the lending side. We have been seeking to find something which would bring in, by and large, anybody who competed on either of those sides with the clearing banks which are subject to our regulations. That is the line of thought which we have pursued, without any startling success up to date.

THE CHAIRMAN: Suppose you have got that far,

of drafting was any policy more or less decided upon, generally, so as to deal with the situation?

LORD COBBOLD: No, I would say it had not been. The first difficulty is in the question of defining banks, and seeing who could be brought under various types of umbrella. Nobody has yet devised a method of --

THE CHAIRMAN: We have had a variety of definitions of things given us. I do not know whether you have another one.

LORD COBBOLD: I think, actually, our main definition is that a bank is anybody who the Bank of England, with the approval of the treasury, says is a bank.

COMMISSIONER GIBSON: In your thinking about it, Lord Cobbold, what are the main considerations? Would they centre around the nature of the deposits and the rate of turnover? Are those factors in your thinking?

LORD COBBOLD: In thinking about near banks?

COMMISSIONER GIBSON: Yes.

LORD COBBOLD: Yes, I have been thinking on both the deposit side and the lending side. We have been seeking to find something which would bring in, by and large, anybody who competed on either of those sides with the clearing banks which are subject to our regulations. That is the line of thought which we have pursued, without any startling success up to date.

THE CHAIRMAN: Suppose you have got that far.

what sort of steps would you consider taking; what sort of controls?

LORD COBBOLD: You could apply something like a special deposit system -- not the same deposit arrangement as is applied to the clearing banks, but you could apply some sort of special deposit system, probably, to the near banks. You could also apply some sort of control by the central authority on their general policy once you definitely regard them as banking institutions. In that case the provisions of the Bank of England Act would apply and you could give directions with the treasury's approval so that they would be brought in under the general unbrella of control. I think those are the first two things.

THE CHAIRMAN: Before we leave that, I suppose a great many of these near banks have substantial dealings with the clearing banks, do they?

LORD COBBOLD: They do.

THE CHAIRMAN: They depend to some considerable extent upon loans, so to that extent they might be affected by bank policy generally.

LORD COBBOLD: That is certainly so.

THE CHAIRMAN: Or is that so? We have had different views expressed.

LORD COBBOLD: That is certainly so in a large number of cases; and, of course, there is an indirect sanction there which operates more in times when deposits are being withdrawn than when deposits are being added to; but there is a certain amount of indirect saction there. Also, on the other side of the balance sheet, as it were, that adds to the friction in some ways.

COMMISSIONER GIBSON: In thinking about near banks, how far do you go in the financial system? Do you get them out of savings institutions?

LORD COBBOLD: Not to the building societies or savings banks. That is pretty clearly regulated and defined, and their practice is well understood. I do not think the clearing banks would feel they are taking any unfair advantage of the rules to be applied to the regular banking system.

THE CHAIRMAN: What about the trust companies? Do they do very much in the way of deposit business?

LORD COBBOLD: Not the trust companies

THE CHAIRMAN: Before we leave that, I suppose a great many of these near banks have substantial dealings with the clearing banks, do they?

LORD COBBOLD: They do.

THE CHAIRMAN: They depend to some considerable extent upon loans, so to that extent they might be affected by bank policy generally.

LORD COBBOLD: That is certainly so.

THE CHAIRMAN: Or is that so? We have had different views expressed.

LORD COBBOLD: That is certainly so in a large number of cases; and, of course, there is an indirect sanction there which operates more in times when deposits are being withdrawn than when deposits are being added to; but there is a certain amount of indirect saction there. Also, on the other side of the balance sheet, as it were, that adds to the friction in some ways.

COMMISSIONER GIBSON: In thinking about near banks, how far do you go in the financial system? Do you get them out of savings institutions?

LORD COBBOLD: Not to the building societies or savings banks. That is pretty clearly regulated and defined, and their practice is well understood. I do not think the clearing banks would feel they are taking any unfair advantage of the rules to be applied to the regular banking system.

THE CHAIRMAN: What about the trust companies? Do they do very much in the way of deposit business?

LORD COBBOLD: Not the trust companies

themselves, as a general rule, no.

COMMISSIONER BROWN: You mentioned a bank or an institution that by name was called such by the Bank of England. Is it a correct assumption they have to request this? It is not a question of your being able to say that such and such an institution is a bank?

LORD COBBOLD: This has never been tested in the courts. I think you will get various legal opinions on this.

COMMISSIONER BROWN: But thus far it has always been at their request?

LORD COBBOLD: Yes, I would say it has always been at their request. There is no doubt, in a great number of cases, that any member of a clearing banking committee and members of a number of other committees are automatically regarded as banks. There is the Board of Trade legislation in the matter requiring returns that also affects this. There is some legal doubt as to exactly who is a bank and who can be given directions by the Bank of England; and this has not yet been tested in the courts, and there is a certain number of marginal cases. There has been a good deal of discussion as to whether there ought to be some new legislation. This was a matter the Radcliffe Committee gave a good deal of attention to, as to whether there should be some new legal definition.

THE CHAIRMAN: For you it would be very simple to have a new letal definition: You could decide what to put into it, and have it. But for us there are

constitutional problems that arise, and the meaning of a bank has not been fully judicially defined.

LORD COBBOLD: You say, Mr. Chairman, it would be easier for us. I have gathered from my legal friends in the U.K. that it would not be all that easy.

THE CHAIRMAN: Oh no, but you have not the constitutional difficulty.

LORD COBBOLD: Certainly, no.

THE CHAIRMAN: I say that because the federal parliament here could not do that.

LORD COBBOLD: This is a subject which I have discussed frequently, at great length, with my Australian colleague too.

THE CHAIRMAN: There is the same difficulty there?

LORD COBBOLD: Yes, there I think banking powers lie with the states.

THE CHAIRMAN: The banking powers lie with the federal authorities here, but the question arises as to what is the limit of that authority.

LORD COBBOLD: Subject to correction, I think in Australia the banking powers lie with the states, and that in Australia it is even more complicated than it is here. It is by no means just a U.K. or Canadian problem, but a world-wide one that is giving a lot of trouble.

COMMISSIONER MACKINTOSH: On this point, my recollection of the Radcliffe Committee report is that on the whole they rather dismissed the near banks as being not too serious a problem. Do I interpret you

constitutional problems that arise, and the meaning of a bank has not been really adequately defined.

LORD COBBOLD: You say, Mr. Chairman, it would be easier for us. I have gathered from my legal friends in the U.K. that it would not be all that easy.

THE CHAIRMAN: Oh no, but you have not the constitutional difficulty.

LORD COBBOLD: [illegible].

THE CHAIRMAN: I say that because the federal parliament here could not do that.

LORD COBBOLD: This is a subject which I have discussed frequently, at great length, with my Australian colleagues [illegible].

THE CHAIRMAN: There is the same difficulty there?

LORD COBBOLD: Yes, there I think banking powers lie with the states.

THE CHAIRMAN: The banking powers lie with the federal authorities here, but the question arises as to what is the limit of that authority.

LORD COBBOLD: Subject to correction, I think in Australia the banking powers lie with the states, and that in Australia it is even more complicated than it is here. It is by no means just a U.K. or Canadian problem, but a world-wide one that is giving a lot of trouble.

[illegible]: [illegible] my recollection of the Radcliffe Committee report is that on the whole they rather dismissed the near banks as being not too serious a problem. Do I interpret you

correctly as not agreeing quite with that?

LORD COBBOLD: I think they were hunting around but did not find any great solution and that they, therefore, hoped it was a matter which would settle itself or which would not obtrude too violently. I do not think I felt the same confidence.

COMMISSIONER MACKINTOSH: Thank you.

THE CHAIRMAN: Is the chief offender the finance company? In view of the relative amount of business that they do and the effect upon the economy that they might have, is that so?

LORD COBBOLD: Yes, but it varies a bit from time to time. That is what we would have called the hire-purchase company?

THE CHAIRMAN: Yes.

LORD COBBOLD: That was a most difficult subject, certainly at one time. More recently some parts of that industry got into difficulties here and there, and I think the difficulty from that side decreased a little. Then, there is a number of people quite outside the market. Even going down to travel agencies and stores, very widely they have been taking deposits and giving what is term credit, but not exactly in the form of a hire-purchase contract. It spreads pretty widely at one time and another, but certainly it stems mainly from finance and hire-purchase companies.

COMMISSIONER LEMAN: I believe you said that there is a number of marginal cases. Are there institutions in England that accept chequing deposits,

correctly as not agreeing quite with that?

LORD COBBOLD: I think they were hunting around but did not find any great solution and that they, therefore, hoped it was a matter which would settle itself or which would not obtrude too violently. I do not think I felt the same confidence.

COMMISSIONER [illegible]: Thank you.

THE CHAIRMAN: Is the chief offender the finance company? In view of the relative amount of business that they do and the effect upon the economy that they might have, is that so?

LORD COBBOLD: Yes, but it varies a bit from time to time. That is what we would have called the hire-purchase company?

THE CHAIRMAN: Yes.

LORD COBBOLD: That was a most difficult subject, certainly at one time. More recently some parts of that industry got into difficulties here and there, and I think the difficulty from that side decreased a little. Then, there is a number of people quite outside the market. Even going down to travel agencies and stores, very widely they have been taking deposits and giving what is term credit, but not exactly in the form of a hire-purchase contract. It spreads pretty widely at one time and another, but certainly it stems mainly from finance and hire-purchase companies.

COMMISSIONER LEMAN: I believe you said that there is a number of marginal cases. Are there institutions in England that accept chequing deposits,

as such, that are not considered banks and do not now come under the jurisdiction?

LORD COBBOLD: I would not know exactly what "chequing deposits" would mean in our terms.

COMMISSIONER LEMAN: Demand deposits.

LORD COBBOLD: Yes.

THE CHAIRMAN: That is what you meant when you used the word "deposits" -- "demands"?

LORD COBBOLD: Yes.

THE CHAIRMAN: If there are no more questions on this we shall proceed to number 4, the effects of monetary policy on the domestic market; the relationship of bank rate to interest rates, generally; the relation of monetary policy to debt management.

LORD COBBOLD: If I might just say a word, first, about general objectives of monetary policy. I do not want to go into this at great length because you will have many more competent witnesses than myself, and many witnesses who know much more about the Canadian scene. I would just like to say, however, that I think there is a considerable measure of unanimity in the central banking profession, and more widely, about objectives. I find, for myself, that I am unable to improve on the words used by the present governor of the Bank of Canada, Mr. Rasminsky, in his statement of August 1st, 1961, in which he said:

> "... the broad aim of the community is to attain, to the maximum extent possible, certain generally accepted objectives: High level employment, high stability and

as such, that are not considered banks and do not now come under the jurisdiction?

LORD COBBOLD: I would not know exactly what "chequing deposits" would mean in our terms.

[illegible]

LORD COBBOLD: Yes.

THE CHAIRMAN: That is what you meant when you used the word "deposits" -- "demands"?

LORD COBBOLD: Yes.

THE CHAIRMAN: If there are no more questions on this we shall proceed to number 4, the effects of monetary policy on the domestic market; the relationship of bank rate to interest rates, generally; the relation of monetary policy to debt management.

LORD COBBOLD: If I might just say a word, first, about general objectives of monetary policy. I do not want to go into this at great length because you will have many more competent witnesses than myself, and many witnesses who know much more about the Canadian scene. I would just like to say, however, that I think there is a considerable measure of unanimity in the central banking profession, and more widely, about objectives. I find, for myself, that I am unable to improve on the words used by the present governor of the Bank of Canada, Mr. Rasminsky, in his statement of August 1st, 1961, in which he said:

"... the broad aim of the community is to attain, to the maximum extent possible, certain generally accepted objectives: High level employment, high stability, and

> sustained economic growth. A flexible monetary policy is an essential element in the total blend of policies directed to these ends. In a situation characterized by large unemployment and unused capacity, monetary policy should be directed to encouraging the use of credit. On the other hand, if the economy is approaching a condition of full stretch, policy should be directed towards discouraging the use of credit."

As I say, as a general statement that seems to me to put it very concisely, and I find myself in entire agreement with it.

The other important thing to underline right away, I think, is that monetary policy is continuously interlocked with fiscal policy -- using the word "fiscal" in its broadest sense, to cover the whole range of government and local authority expenditure, taxation and borrowing, which can never be kept in separate compartments without regard one to the other. The general line of monetary and fiscal policy must be complementary or at least not contradictory. And the complaint of most central bankers, including myself, over the post-war years has been that they have been left to carry too heavy a part of the battle against inflation, with insufficient support from the fiscal side. I have always maintained that an attempt to stem inflation and keep prices steady, by credit controls and interest rare policy alone, is doomed to

> sustained economic growth. A flexible monetary policy is an essential element in the total blend of policies directed to these ends. In a situation characterized by large unemployment and unused capacity, monetary policy should be directed to encouraging the use of credit. On the other hand, if the economy is approaching a condition of full stretch, policy should be directed towards discouraging the use of credit."

As I say, as a general statement that seems to me to put it very concisely, and I find myself in entire agreement with it.

The other important thing to underline right away, I think, is that monetary policy is continuously interlocked with fiscal policy -- using the word "fiscal" in its broadest sense, to cover the whole range of government and local authority expenditure, taxation and borrowing, which can never be kept in separate compartments without regard one to the other. The general line of monetary and fiscal policy must be complementary or at least not contradictory. And the complaint of most central bankers, including myself, over the post-war years has been that they have been left to carry too heavy a part of the battle against inflation, with insufficient support from the fiscal side. I have always maintained that an attempt to stem inflation and keep prices steady, by credit controls and interest rate policy alone, is doomed to

failure if the budget and public expenditure policies are working the other way. I would judge myself -- though we have fortunately not yet had to face this position since the war -- that an injection of credit and low interest rates would be even less able, all by itself and without support in other fields, to counteract a serious recession. But given an agreed general line of policy, credit controls and intefest rate policies have proved themselves in the post-war period: They are much more flexible than taxation and long-term public expenditure; they can be adapted fairly frequently and pushed a little now in one direction and now in the other as the economic wind veers. The metaphor of driving a car along the road has been criticized as being stale, but I still think it the most descriptive. It makes no sense to drive along the highway with one foot continuously on the brake and the other foot continuously on the accelerator; and this is what happens if you have a restrictive money policy and an expansionist budget, or the other way around. On the other hand, once you have decided the sort of average speed your engine and the state of the road can take, it makes every sort of sense to use a touch of the brake at one moment and a touch of the accelerator at another. But there is another limitation to the effectiveness of monetary measures which is often forgotten, unless the measures are savage and violent -- and savage and violent measures should be reserved for crisis conditions because they upset the economy and disturb healthy growth -- they take time

failure if the budget and public expenditure policies are working the other way. I would judge myself -- though we have fortunately not yet had to face this position since the war -- that an injection of credit and low interest rates would be even less able, all by itself and without support in other fields, to counteract a serious recession. But given an agreed general line of policy, credit controls and interest rate policies have proved themselves in the post-war period: They are much more flexible than taxation and long-term public expenditure; they can be adapted fairly frequently and pushed a little now in one direction and now in the other as the economic wind veers. The metaphor of driving a car along the road has been criticized as being stale, but I still think it the most descriptive. It makes no sense to drive along the highway with one foot continuously on the brake and the other foot continuously on the accelerator; and this is what happens if you have a restrictive money policy and an expansionist budget, or the other way around. On the other hand, once you have decided the sort of average speed your engine and the state of the road can take, it makes every sort of sense to use a touch of the brake at one moment and a touch of the accelerator at another. But there is another limitation to the effectiveness of monetary measures which is often forgotten, unless the measures are savage and violent -- and savage and violent measures should be reserved for crisis conditions because they upset the economy and disturb healthy growth -- they take time

to work through. You cannot expect a gentle change in the emphasis of credit policy to take effect in a week or two. Our own experience in the United Kingdom is that it takes something like six months before a switch from easy to tight conditions, or the reverse movement, works right through the system.

Under the United Kingdom practice, which differs, of course, from other practices, the commercial bank lending rates are directly related to the bank rate, and I think that is a very important point and a considerable difference between the British practice and many other practices, one which means the bank rate is something more immediately real than it is in a number of other markets. That is to say, the majority of commercial bank lending arrangements are expressed, so far as the rate of interest is concerned, as the bank rate plus one or the bank rate plus one and a half, varying with the minimum. So, if the bank rate is at all on the upward swing -- probably anywhere upwards of 3½ -- it immediately impinges on the direct charge of the lending rate of the commercial banking system. That is to say, when, for example, the bank rate was increased by two points at one of our more difficult moments, that automatically increased the charge of the banking community's lending rates to pracgically all their customers by 2 per cent. That is an immediate and direct relationship.

A change in the bank rate will also, under our arrangements, immediately affect the short-term money rate which will immediately come into adjustment

to work through. You cannot expect a gentle change in the emphasis of credit policy to take effect in a week or two. Our own experience in the United Kingdom is that it takes something like six months before a switch from easy to tight conditions, or the reverse adjustment, works right through the system.

Under the United Kingdom practice, which differs, of course, from other practices, the commercial bank lending rates are directly related to the bank rate, and I think that is a very important point and a considerable difference between the British practice and many other practices, one which means the bank rate is something more immediately real than it is in a number of other markets. That is to say, the majority of commercial bank lending arrangements are expressed, so far as the rate of interest is concerned, as the bank rate plus one or the bank rate plus one and a half, varying with the minimum. So, if the bank rate is at all on the upward swing -- probably anywhere upwards of $3\frac{1}{2}$ -- it immediately impinges on the direct charge of the lending rate of the commercial banking system. That is to say, when, for example, the bank rate was increased by two points at one of our more difficult moments, that automatically increased the charge of the banking community's lending rates to practically all their customers by 2 per cent. That is an immediate and direct relationship.

A change in the bank rate will also, under our arrangements, immediately affect the short-term money rate which will immediately come into adjustment

with the clearing banks' deposit rate, which is, again, related to the clearing banks' lending rate and, therefore, immediately affected by a change in the bank rate. That is so far as short-term money rates -- treasury bills and short-term government securities maturing within one, two or three years, or thereabouts, and perhaps up to five years, are concerned.

So far as long-term interest rates are concerned, the position is distinctly different. On the text book, of course, an increase in bank rate ought to put up rates right through the whole picture, and a decrease in the bank rate ought to bring them down right through the whole picture. As a matter of fact, that has not always proved the case, and there have been occasions when an increase in the bank rate has had the opposite effect, in the long-term rates, merely because the factor of confidence enters so largely into this, and when, for example, there has been a time when things have been drifting a little and not enough is being done by the authorities to keep the thing in hand, long-term gilt-edged prices have been sagging. It has several times happened that firm action, including a strong increase in the bank rate, has actually improved long-term prices from a confidence angle, and have, therefore, made long-term borrowing a touch cheaper instead of a touch more expensive. Those are, as a rule, temporary, and by and large, the bank rate, under our system, does have some influence right through the system but much more at the short end than at the long end.

with the clearing banks' deposit rate, which is, again, related to the clearing banks' lending rate and, therefore, immediately affected by a change in the bank rate. That is so far as short-term money rates -- treasury bills and short-term government securities maturing within one, two or three years, or thereabouts, and perhaps up to five years, are concerned.

So far as long-term interest rates are concerned, the position is distinctly different. On the text book, of course, an increase in bank rate ought to put up rates right through the whole picture, and a decrease in the bank rate ought to bring them down right through the whole picture. As a matter of fact, that has not always proved the case, and there have been occasions when an increase in the bank rate has had the opposite effect, in the long-term rates, merely because the factor of confidence enters so largely into this, and when, for example, there has been a time when things have been drifting a little and not enough is being done by the authorities to keep the thing in hand, long-term gilt-edged prices have been sagging. It has several times happened that firm action, including a strong increase in the bank rate, has actually improved long-term prices from a confidence angle, and have, therefore, made long-term borrowing a touch cheaper instead of a touch more expensive. Those are, as a rule, temporary, and by and large, the bank rate, under our system, does have some influence right through the system but much more at the short end than at the long end.

If I may turn, just for a moment, to the relationship between monetary policy, the bank rate, etc., and debt management, which I have just touched on in those last remarks. The fundamental objective of debt management is to ensure that government can borrow for its requirements at a reasonable rate of interest and that maturities are so spread as not to embarrass the authorities at any one time. Debt management is to be considered an important part of wider fiscal policy, and needs, therefore, to be harmonized with monetary policy. Here too there may often be a conflict between objectives. Whilst the importance of borrowing as cheaply as possible must always be borne in mind, there are very often situations when this objective is over-ridden by the necessity of keeping in line with monetary policy when it is directed towards tighter money conditions. Practice in the United Kingdom, where the authorities intervene regularly and sometimes heavily in the gilt-edged market, has been to steady prices, to restrain movements and occasionally to nudge the market in one direction or the other. It has never been United Kingdom practice to attempt to reverse a strong market trend in the gilt-edged market. That is a point which was very much to the fore in our discussions with the Radcliffe Committee, as some members of your Commission may remember. The general policy -- or I would rather, perhaps, say the general operational technique of the Bank of England over the past few years has been that we are generally concerned to purchase in the market

If I may turn, just for a moment, to the relationship between monetary policy, the bank rate, etc., and debt management, which I have just touched on in those last remarks. The fundamental objective of debt management is to ensure that government can borrow for its requirements at a reasonable rate of interest and that maturities are so spread as not to embarrass the authorities at any one time. Debt management is to be considered an important part of wider fiscal policy, and needs, therefore, to be harmonized with monetary policy. Here too there may often be a conflict between objectives. Whilst the importance of borrowing as cheaply as possible must always be borne in mind, there are very often situations when this objective is over-ridden by the necessity of keeping in line with monetary policy when it is directed towards tighter money conditions. Practice in the United Kingdom, where [illegible] regularly and sometimes heavily in the gilt-edged market, has been to steady prices, to restrain movements and occasionally to nudge the market in one direction or the other. It has never been United Kingdom practice to attempt to reverse a strong market trend in the gilt-edged market. That is a point which was very much to the fore in our discussions with the Radcliffe Committee, as some members of your Committee may remember. The general policy -- or I would rather, perhaps, say the general operational technique of the Bank of England over the past few years has been that we are generally concerned to purchase in the market

the next maturities of government stock, so as to ensure a successful conversion. That is to say that in the year or two, and more particularly in the months preceding a maturity date, the issue department will be guying stock in the market so that when the time comes to repay or convert that particular line the issue department will hold as high a percentage as possible of that particular loan so as to make the conversion operation an easier one. The practice has also been, particularly since the war, that new long-term government issues are largely taken up, in the first instance; by the issue department of the Bank of England and sold gradually over succeeding weeks and months. We naturally try, so to speak, to clear our book of a new loan within a reasonable time and not to get stuck up with it indefinitely; and we always like to have the great majority of an issue sold on the market before making another government long-term issue. The reason for that process is that the market just cannot absorb on one day £ 200 million or £ 300 million of government stock, or whatever it might be.

We have at times had a tap loan -- we had a tap loan all through the war -- but generally speaking, in these times and conditions, we have found a tap loan inconvenient because it pegs the level of long-term interest rate and rather prejudices one's flexibility of action in later months; and we have generally decided that this more flexible arrangement, by which the issue department takes the stock on its book and

the next maturities of government stock, so as to ensure a successful conversion. That is to say that in the year or two, and more particularly in the months preceding a maturity date, the issue department will be buying stock in the market so that when the time comes to repay or convert that particular line the issue department will hold as high a percentage as possible of that particular loan so as to make the conversion operation an easier one. The practice has also been, particularly since the war, that new long-term government issues are largely taken up, in the first instance, by the issue department of the Bank of England and sold gradually over succeeding weeks and months. We naturally try, so to speak, to clear our book of a new loan within a reasonable time and not to get stuck up with it indefinitely; and we always like to have the great majority of an issue sold on the market before making another government long-term issue. The reason for that process is that the market just cannot absorb on one day £ 200 million or £ 300 million of government stock, or whatever it might be.

We have at times had a tap loan -- we had a tap loan all through the war -- but generally speaking in these times and conditions, we have found a tap loan inconvenient because it pegs the level of long-term interest rate and rather prejudices one's flexibility of action in later months; and we have generally decided that this [illegible] which the issue department takes the stock on its book and

in fact leaves the stock on tap to the market in the succeeding months, is much more flexible because it can alter that tap and can close it at any moment and can increase or decrease the volume of sales, and it can adjust the price at which it is prepared to sell that stock in conformity with the general movement of the money rates.

In fact leaves the stock go up [illegible] in the succeeding months, is much more [illegible] [illegible] that tap and can close it at any moment and can increase or decrease the volume of [illegible] It can adjust the price at which it is prepared to sell that stock in conformity with the general demands of the money market.

I don't say that will necessarily remain the way in which we do it, and I do not say it may not in certain conditions prove convenient to make an issue and expect it to be taken up outside along one day, or we may find it convenient at certain times to revert to the pure tap loan method. This method we have adopted has proved very successful subject to the fact that one does not allow the issue department book to get too full of any particular security so that that, in fact, becomes gummed up and it prejudices your subsequent operations.

In the early days after the war our problem was we were left with a very heavy floating debt, and our internal technical problem was to get that funded into a more manageable permanent or semi-permanent debt structure. In the event we had to finance a good deal of that short, partly because it was not practicable to fund it long and partly because at times during the period rates had been on the high side, and we did not wish to fund too long at too high rates. The effect of that has been that in every year for the last ten years, and it will be the position in every year pretty well for the next period, there has been a pretty heavy maturity to be dealt with that arises mainly out of the funding of this short-term floating debt which we were left with at the end of the war. That has been a very constant and difficult problem never very far away from our minds, because when one gets rid of a 1958 maturity one observes there is something more coming up in 1959, and so on,

I don't say that will necessarily remain the way in which we do it, and I do not say it may not in certain conditions prove convenient to make an issue and expect it to be taken up outside along one day, or we may find it convenient at certain times to revert to the pure tap loan method. This method we have adopted has proved very successful subject to the fact that one does not allow the issue department book to get too full of any particular security so that that, in fact, becomes gummed up and it prejudices your subsequent operations.

In the early days after the war our problem was we were left with a very heavy floating debt, and our internal technical problem was to get that funded into a more manageable permanent or semi-permanent debt structure. In the event we had to finance a good deal of that short, partly because it was not practicable to fund it long and partly because at times during the period rates had been on the high side, and we did not wish to fund too long at too high rates. The effect of that has been that in every year for the last ten years, and it will be the position in every year pretty well for the next period, there has been a pretty heavy maturity to be dealt with that arises mainly out of the funding of this short-term floating debt which we were left with at the end of the war. That has been a very constant and difficult problem never very far away from our minds, because when one gets rid of a 1958 maturity one observes there is something more coming up in 1959, and so on,

and one is never far away from it.

I say that is a relic of war-time finance very largely, and on the whole we have managed to spread that out in a way which though it causes us continuous thought is, I think, not an undue embarrassment.

It might be perhaps of interest as an obiter dictum to the Commission: I occasionally dip into Clapham's History of the Bank of England, and if one reads the chapters relating to the period immediately after the Marlborough wars or after the Napoleonic wars you find exactly the same page after page: "The governor and deputy governor called on the Chancellor to discuss the problem of funding the floating debt", and it happens again and again throughout the history, and it is extraordinary the degree to which the words used by our predecessors a century and two centuries ago are precisely in the same terms as the words which we have been using in Whitehall since the last war.

I think that about covers that, sirs, for the moment.

THE CHAIRMAN: You mentioned the aims of monetary policy. Of course, I think it no doubt is quite obvious that at times there is the conflict between one and another, between price stability on some occasions and perhaps full employment on the other. Do you find any special priority that should be attached to one of these aims over the other when there is a conflict?

LORD COBBOLD: I would agree, sir, entirely that there is a frequent conflict in that. My own view is that it requires a continuous exercise of judgment.

I say that is a relic of war-time finance very largely, and on the whole we have managed to spread that out in a way which though it causes us continuous thought is, I think, not an undue embarrassment.

It might be perhaps of interest as an obiter dictum to the Commission: I occasionally dip into Clapham's History of the Bank of England, and if one reads the chapters relating to the period immediately after the Marlborough wars or after the Napoleonic wars you find exactly the same page after page: "The governor and deputy governor called on the Chancellor to discuss the problem of funding the floating debt", and it happens again and again throughout the history, and it is extraordinary the degree to which the words used by our predecessors a century and two centuries ago are precisely in the same terms as the words which we have been using in Whitehall since the last war.

I think that about covers that, sirs, for the moment.

THE CHAIRMAN: You mentioned the aims of monetary policy. Of course, I think it no doubt is quite obvious that at times there is the conflict between one and another, between price stability on some occasions and perhaps full employment on the other. Do you find any special priority that should be attached to one of these aims over the other when there is a conflict?

LORD COBBOLD: I would agree, sir, entirely that there is a frequent conflict in that. My own view is that it requires a continuous exercise of judgment.

and that at one time one thing may be more important, and that at another time another aspect may be important, and really that is what the people in my late profession have, therefore, to try to weigh up at one time or another: to which of those they should attach the most importance.

I think I would just say this, and certainly this is true of general policy in the United Kingdom: I think the one thing that most people in authority in the United Kingdom at this moment, most of whom lived through the 30's in their earlier years, are determined not to see again is any high level of unemployment. I would think in many people's minds, and as a general proposition that would go for me, I think I would tend to put that as the highest priority of the lot.

THE CHAIRMAN: When you contemplate full employment it can hardly be said that monetary policy alone can accomplish that?

LORD COBBOLD: Certainly.

THE CHAIRMAN: And as you have already mentioned, that would have to be in conjunction with fiscal policy or some other policies which may be beyond the strict purview of monetary policy.

LORD COBBOLD: If I were to put it negatively, I should regard anything like mass unemployment as the greatest failure on behalf of the fiscal and monetary authorities of any failure they could make under present circumstances. By that I do not mean until tomorrow: I mean quite some while ahead. I should not regard it as any achievement of the fiscal and monetary authorities to keep the level of employment up by methods and means

and that at [illegible] one time one thing may be more important, [illegible] to which of those they should attach the most importance.

I think I would just say this; and certainly this is true of general policy in the United Kingdom: I think the one thing that most people in authority in the United Kingdom at this moment, most of whom lived through the 30's in their earlier years, are determined not to see again is any high level of unemployment. I would think in many people's minds, and as a general proposition that would go for me. I think I would have to put that as the highest priority of the lot.

THE CHAIRMAN: When you contemplate full employment it can hardly be said that monetary policy [illegible]

[illegible]

THE CHAIRMAN: And as you have already mentioned, that would have to be in conjunction with fiscal policy or some other policies which may be beyond the strict purview of monetary policy.

LORD COBBOLD: If I were to put it negatively, I should regard anything like mass unemployment as the greatest failure on behalf of the fiscal and monetary authorities of any failure they could make under present circumstances. By that I do not mean until tomorrow; I mean quite some while ahead. I should not regard it [illegible] economy authorities to keep the level of employment or of methods and means

which would quite inevitably lead to mass unemployment in years to come. I think there is quite often a danger in some thinking to think too short on this subject.

THE CHAIRMAN: On the other hand, a great deal would depend on the cause of the particular unemployment situation?

LORD COBBOLD: What I really had in mind was that it is probably easy to keep full or fullish employment by a very easy money policy for a very short time; let your prices go up and not bother about your competitiveness. However, as certain as night follows day that will lead you into trouble in your balance of payments situation and competitive situation and is bound to cause unemployment at a later stage, and you are no whit further forward, and you are somewhat further backward. I think you have to keep the longish view on that.

THE CHAIRMAN: There are certain structural changes in the economy from time to time which might give it a new direction which monetary policy would have very little to do with -- you could hardly rely on monetary policy to have much effect?

LORD COBBOLD: I would agree. I think it will in almost all situations have some effect. The amount of effect it will have depends normally on the different situations. I would think an extreme monetary policy will always have an effect. A very tight monetary policy and very high interest rates will always have a considerable effect; and a very easy monetary policy and very low interest rates will always have an effect on almost

which would quite inevitably lead to mass unemployment in years to come. I think there is quite often a danger in some thinking to think too short on this subject.

THE CHAIRMAN: On the other hand, a great deal would depend on the cause of the particular unemployment situation?

LORD COBBOLD: What I really had in mind was that it is probably easy to keep full or fuller employment by a very easy money policy for a very short time; let your prices go up and not bother about your competitiveness. However, as certain as night follows day that will lead you into trouble in your balance of payments situation and competitive situation and is bound to cause unemployment at a later stage, and you are no whit further forward, and you are somewhat further backward. I think you have to keep the longish view on that.

THE CHAIRMAN: There are certain structural changes in the economy from time to time which might give it a new direction which monetary policy would have very little to do with -- you could hardly rely on monetary policy to have much effect?

LORD COBBOLD: I would agree. I think it will in almost all situations have some effect. The amount of effect it will have depends normally on the different situations. I would think an extreme monetary policy will always have an effect. A very tight monetary policy and very high interest rates will always have a considerable effect; and a very easy monetary policy and very low interest rates will always have an effect on almost

any situation which I can envisage. However, it certainly is true what one would call moderate adjustments will have much more effect in some circumstances than in others.

THE CHAIRMAN: When you speak of the stability of prices you have contemplated a certain fluctuation.

LORD COBBOLD: Surely.

THE CHAIRMAN: Within limits.

LORD COBBOLD: Yes.

THE CHAIRMAN: I understand in Sweden they had a four per cent inflationary increase from year to year ever since the last war. They do not seem to be very much concerned about that.

LORD COBBOLD: No.

THE CHAIRMAN: Is there any rule that you can apply to the sort of fluctuation of prices that would be in keeping with --

LORD COBBOLD: I think only the rather general rule that one would not like to see it run at all too quickly and not like to see it out-distance the increase in productivity. I think we must all face the fact that at least since the war -- certainly in the United Kingdom and probably all western countries -- pressures have been inflationary pressures, and what we have been concerned to do is try and damp down a bit when we have seen opportunities without doing damage to economic growth.

THE CHAIRMAN: That is another point I was going to mention: Sustained economic growth is another problem which on the face of it might involve some

any situation which I can envisage. However, it certainly is true what one would call moderate adjustments will have much more effect in some circumstances than in others.

THE CHAIRMAN: When you speak of the stability of prices you have contemplated a certain fluctuation.

LORD COBBOLD: Surely.

THE CHAIRMAN: Within limits.

LORD COBBOLD: Yes.

THE CHAIRMAN: I understand in Sweden they had a four per cent inflationary increase from year to year ever since the last war. They do not seem to be very much concerned about that.

LORD COBBOLD: No.

THE CHAIRMAN: Is there any rule that you can apply to the sort of fluctuation of prices that would be in keeping with --

LORD COBBOLD: I think only the rather general rule that one would not like to see it run at all too quickly and not like to see it out-distance the increase in productivity. I think we must all face the fact that at least since the war -- certainly in the United Kingdom and probably all western countries -- pressures have been inflationary pressures, and what we have been concerned to do is try and damp down a bit when we have seen opportunities without doing damage to economic growth.

THE CHAIRMAN: That is another point I was going to mention: Sustained economic growth is another problem which on the face of it might involve some

inflationary pressures, necessarily.

LORD COBBOLD: Necessarily some. When I talk about price stability, that really means, except possibly in some world prices for commodities, trying to maintain price stability downwards. Most of my central banking colleagues around the world would agree that in practice since the war that has meant trying to keep the upward movement of prices from getting out of hand. It has not involved conscious efforts to keep prices up.

THE CHAIRMAN: When was the last time you might say there was reasonable stability of prices?

LORD COBBOLD: I am afraid before I was in the business.

COMMISSIONER LEMAN: Lord Cobbold, you have used the mataphor, and I would like to take a little drive with you if you are willing to take the wheel: Do you, in fact, in the United Kingdom in your discussions with government set quantitative values on these various objectives in terms of unemployment, rate of growth and price stability? Can you do a little bit of both short-term and long-term planning in terms of actual figures -- set yourself targets?

LORD COBBOLD: I would not say we set ourselves actual targets in that sense, but in every discussion on this subject which I recollect all these points have been raised and, so to speak, have been put from different positions at the table and from different points of view. I think they have always been raised and at different times a different degree of importance has been attached to each of these factors.

LORD COBBOLD: Necessarily some. When I talk about price stability, that really means, except possibly in some world prices for commodities, trying to maintain price stability downwards. Most of my central banking colleagues around the world would agree that in practice since the war that has meant trying to keep the upward movement of prices from getting out of hand. It has not involved conscious efforts to keep prices up.

THE CHAIRMAN: When was the last time you might say there was reasonable stability of prices?

LORD COBBOLD: I am afraid before I was in the business.

COMMISSIONER LEMAN: Lord Cobbold, you have used the metaphor, and I would like to take a little drive with you if you are willing to take the wheel: Do you, in fact, in the United Kingdom in your discussions with government set quantitative values on these various objectives in terms of unemployment, rate of growth and price stability? Can you do a little bit of both short-term and long-term planning in terms of actual figures -- set yourself targets?

LORD COBBOLD: I would not say we set ourselves actual targets in that sense, but in every discussion on this subject which I recollect all these points have been raised and, so to speak, have been put from different positions at the table and from different points of view. I think they have always been raised and at different times a different degree of importance has been attached to each of these factors.

I would repeat, however, that over the period in most people's minds the fear of possible unemployment on any large scale tends to be the dominating one except for immediate pressures on the balance of payments and the foreign exchanges which I was going to come to in more detail a little later. However, of the general considerations running through there has always been emphasis on keeping as much price stability as possible; always emphasis on maintaining industrial expansion and growth. I think perhaps I should put it that as the chief background fear or concern in people's minds remains the unemployment one. I think I might probably say that is a very great distinction from the attitude taken by some of our continental central banking friends, particularly in the countries where they suffered very heavy inflation, where I should say that the major concern at the back of almost everybody's minds has been to avoid the risk of inflation again at any cost. That is in those countries where savings have disappeared once or twice in a generation, and there there is no doubt that whilst with us, and perhaps with you and in the United States unemployment has been the dominant of these factors, in certain central European countries the avoidance of inflation has been the dominant one in their minds.

COMMISSIONER LEMAN: In talking about unemployment you must set yourself targets in a sense of what you consider an acceptable percentage or not an acceptable percentage?

LORD COBBOLD: I think that varies from time

I would repeat, however, that over the period [illegible] our large scale tends to be the dominating one except for immediate pressures on the balance of payments and the foreign exchanges which I was going to come to in more detail a little later. However, of the general [illegible] emphasis on keeping as much price stability as possible; always emphasis on maintaining industrial expansion and growth. I think perhaps I should put it that as the chief background fear or concern in people's minds remains the unemployment one. I think I might probably say that is a very great distinction from the attitude taken by some of our continental central banking friends, particularly in the countries where they suffered very heavy inflation, where I should say that the major concern at the back of almost everybody's minds has been to avoid the risk of inflation again at any cost. That is in those countries where savings have disappeared once or twice in a generation, and there there is no doubt that whilst with us, and perhaps also you and in the United States unemployment has been the dominant of these factors, in certain central European countries the avoidance of inflation has been the dominant one in their minds.

COMMISSIONER LEMAN: In talking about unemployment you must set yourself targets in a sense of what you consider an acceptable percentage or not an acceptable percentage?

[illegible]

to time, and the exact percentages would be much more a political consideration than a central banking consideration.

COMMISSIONER MACKINTOSH: Would you carry that distinction further and say that control of inflation or stability of the price level was a peculiar concern of the central bank in that it could do more about it than it could do about unemployment?

LORD COBBOLD: Yes, I would say one is thinking about it every day more because it is the material of one's everyday business. Speaking for myself, I think I would repeat that if I had gone out of the bank and seen mass unemployment I should have thought I had done worse if I had gone out and seen almost any other condition. I think it is something which all our generation has very much in the back of its mind.

COMMISSIONER MACKINTOSH: I certainly agree as an economic objective, but provided fiscal policy has gone ahead, can the bank do, actually, very much?

LORD COBBOLD: No, I don't think so. I was asked what was the prior thing at the back of people's minds, and I think it is that. However, in all our day-to-day thinking I think one is much more concerned with the other things: Stability and keeping a reasonable rate of growth and expansion.

COMMISSIONER MACKINTOSH: Not that they are more important?

LORD COBBOLD: No, but they are more closely associated with the practical things one can do from day-to-day. I have, myself, always looked with the

greatest interest, not so to speak as a guider of policy, but as an indication at the graph of unfilled vacancies and employment. It has often seemed to us when that graph crosses it shows the thing is beginning to move in the other way. You are familiar with the graphs I mean, I am sure.

COMMISSIONER MACKINTOSH: Yes.

COMMISSIONER LEMAN: In more precise terms, though, I suppose at budget time there is discussion between government and bank about the average speed of the engine and the state of the road: Does it get down to brass tacks, or only very general?

LORD COBBOLD: Not only at budget times; continuously throughout the year, in various forums between the chancellor and the governor, between the officials, and quite often at a round-table meeting with the various people concerned; by no means only on budget day -- and they get very much down to brass tacks in terms of what one can do about it.

COMMISSIONER LEMAN: I was perhaps thinking of something different. I can understand where you would keep talking about these things all through the year, but at budget time is it more possible to set precise targets for the fiscal year?

LORD COBBOLD: More possible because that is the only time it can be done; that is why I was saying monetary policy tends to be more flesible because you can deal with it during the year and not only at one time. When the chancellor has set his budget policy he is, within some limits, committee for the year and

greatest interest, not so to speak as a guide of policy, but as an indication of the graph of unfilled vacancies and employment. It has often seemed to us when [illegible] move in one other [illegible] I mean, I am sure.

COMMISSIONER MACKINTOSH: Yes.

COMMISSIONER LEMAN: In more precise terms, though, I suppose at budget time there is discussion between government and bank about the average speed of the engine and the state of the road: Does it get down to brass tacks, or only very general?

[illegible] continuously throughout the year, in various forums between the chancellor and the governor, between the [illegible] the various people concerned; by no means only on budget day -- and they get very much down to brass tacks in terms of what one can do about it.

COMMISSIONER LEMAN: I was perhaps thinking of something different. I can understand where you would keep talking about these things all through the year, but at budget time is it more possible to set precise target for the fiscal year?

LORD COBBOLD: More possible because that is the only time it can be done; that is why I was saying monetary policy tends to be more flexible because you can deal with it during the year and not only at one time. When the chancellor has set his budget policy he is, within some limits, committed for the year and

has to take a definite view for the year ahead. In regard to the sort of machinery I was speaking about just now, you can take account of movements through the year or at any time, and consider the measures, which must be largely monetary measures, you can take next week or next month .

[illegible]

[illegible] account of movements through the year [illegible] and consider the measures, which must [illegible]ly monetary measures, you can take next week [illegible]

COMMISSIONER LEMAN: Is the government willing to consult with the bank on actual figures on what they will shoot for in the way of expenditures, borrowing, et cetera, and see if the bank feels that that will fit in properly with what it thinks a proper monetary policy?

LORD COBBOLD: It has been recent practice that the Chancellor would bring us pretty fully into that picture, yes.

COMMISSIONER GIBSON: I would like to ask you a question, Lord Cobbold, about full employment and growth as two objectives. It is frequently the case that people seem to think that this is the same thing, but in the United Kingdom in the post war period you have had a very high rate of employment most of the time, but in recent years not a very high rate of growth. Now, do you see any conflict or basic difference between these two objectives?

LORD COBBOLD: In the sense that I should have been happier if I had seen a larger rate of growth over the last few years?

COMMISSIONER GIBSON: Do you think there is any conflict between the objective of a fairly high rate of growth and an immediate objective of full employment?

LORD COBBOLD: Certainly; if you get to an overfull employment stage there certainly is, and we have had that once or twice with all the familiar things, a bottleneck effect on prices, and so on, and there have been certainly several periods within the

COMMISSIONER LEMAN: Is the government willing to consult with the bank on actual figures on what they will shoot for in the way of expenditures, borrowing, et cetera, and see if the bank feels that that will fit in properly with what it thinks a proper monetary policy?

LORD COBBOLD: It has been recent practice that the Chancellor would bring us pretty fully into that picture too.

COMMISSIONER GIBSON: I would like to ask you a question, Lord Cobbold, about full employment and growth as two objectives. It is frequently the case that people seem to think that this is the same thing, but in the United Kingdom in the post war period you have had a very high rate of employment most of the time, but in recent years not a very high rate of growth. Now, do you see any conflict or basic difference between these two objectives?

LORD COBBOLD: In the sense that I should have been happier if I had seen a larger rate of growth over the last few years?

COMMISSIONER GIBSON: Do you think there is any conflict between the objective of a fairly high rate of growth and an immediate objective of full employment?

LORD COBBOLD: Certainly; if you get to an overfull employment stage there certainly is, and we have had that once or twice with all the familiar things, a bottleneck effect on prices, and so on, and there have been certainly several periods within the

last twelve years where there has been definite over-employment and definite shortage of labour, particularly skilled and semi-skilled labour, which has impeded growth.

COMMISSIONER GIBSON: Would you say, sir, that the Bank of England's policies have had a major part to play in this full employment picture which you have had most of the time, or have you mainly been concerned with preventing it from going into another situation?

LORD COBBOLD: I think we have been mainly concerned with combatting the inflationary situation, because I think all the pressures since the war have been inflationary pressures and unemployment has been a distant bug-bear; it has never been a very present danger. I think it is probably true that all the time that I was deputy governor or governor one's preoccupation was how to cope with pretty consistent inflationary pressures and pretty definite risks of exchange difficulties and balance of payment difficulties around the corner. These have been the current problems all the time.

COMMISSIONER MACKINTOSH: You don't feel that that is now changed?

LORD COBBOLD: I wouldn't know, sir.

COMMISSIONER LEMAN: You did make a point that the fiscal policy was extremely closely interrelated with the monetary policy. Also in a discussion you talked about the fields where one body could take the initiative and the other one act as

last twelve years [illegible]

[illegible]

[illegible]

growth.

COMMISSIONER [illegible]: Would you say, sir, that the Bank of England's policies have had a major part to play in this full employment picture which you have had most of the time, or have you mainly been concerned with preventing it from going into another situation?

LORD COBBOLD: I think we have been mainly concerned with combatting the inflationary situation, because I think all the pressures since the war have been inflationary pressures and unemployment has been a distant bug-bear; it has never been a very present danger. I think it is probably true that all the time that I was deputy governor or governor one's preoccupation was how to cope with pretty consistent inflationary pressures and pretty definite risks of exchange difficulties and balance of payment difficulties around the corner. These have been the current problems all the time.

COMMISSIONER MACKINTOSH: You don't feel that that is now changed?

LORD COBBOLD: I wouldn't know, sir.

COMMISSIONER LEMAN: You did make a point that the fiscal policy was extremely closely inter-related with the monetary policy. Also in a discussion you talked about the fields where one would take the initiative and the other one act as

counsel or moderator, perhaps, and in other fields it would be the other way around. Now, would you go so far as to say they are so interlocked that one could go so far as to say that the government could establish after consultation, say, with the bank and the monetary authorities what they will go for as a programme, but thereafter should leave to the monetary authority all matters of maturities and interest rates, et cetera.

LORD COBBOLD: No, I would prefer to see continuous consultation myself, because I think the general picture changes a lot all the time, and I think if you were to ask the government to establish something at a given date and then consider two months after that what you were going to do about it, I would much rather know what the government is thinking on the same date as I was taking the subsequent action. I wouldn't like to see that too static.

COMMISSIONER LEMAN: You visualize it as much a matter of give and take all the time?

LORD COBBOLD: Yes, all the time.

COMMISSIONER LEMAN: And not too much separation?

LORD COBBOLD: No.

COMMISSIONER LEMAN: Earlier you also talked about the government broker, what he does -- perhaps I am getting ahead of myself and getting into techniques here, but to what extent does the government broker know exactly what your position is in a situation?

[illegible]

[illegible]

go so far as to say they are so interlocked that one could go so far as to say that the government could establish after consultation, say, with the bank and the monetary authorities what they will go for as a programme, but thereafter should leave to the monetary authority all matters of maturities and interest rates, et cetera.

LORD COBBOLD: No. I would prefer to see continuous consultation myself, because I think the general picture changes a lot all the time, and I think if you were to ask the government to establish something at a given date and then consider two months after that what you were going to do about it, I would much rather know what the government is thinking on the same date as I was taking the subsequent action. I wouldn't like to see that too static.

COMMISSIONER LEMAN: You visualize it as much a matter of give and take all the time?

LORD COBBOLD: Yes, all the time.

COMMISSIONER LEMAN: And not too much

[illegible]

LORD COBBOLD: No.

[illegible]

talked about the government broker, what he does -- perhaps I am getting ahead of myself and getting into techniques here, but to what extent does the government broker know exactly what your position is in a situation

Is he fully informed?

LORD COBBOLD: He is fully informed immediately before we act. Not by any means is it necessary to inform him of forward policy.

THE CHAIRMAN: We will continue this after lunch. We will adjourn now until 2:30 this afternoon.

---LUNCHEON ADJOURNMENT

---ON RESUMING AT 2:30 P.M.

THE CHAIRMAN: We shall now resume.

COMMISSIONER LEMAN: Lord Cobbold, to resume where we left off before lunchtime, we were talking about the subjects which you put under section 4 here, and one of them -- I will not necessarily take them in order -- one of them is the relationship of debt management to monetary policy, and I asked you a couple of questions about that and I would like to ask you a couple more.

In the handling of government issues, could you give us a brief run-down on the curriculum that is used for getting new government data to the public?

LORD COBBOLD: Could you develop that question a little bit? The curriculum that is used --

COMMISSIONER LEMAN: I understand that the government primarily takes the initiative in this deal and decides how much it needs and consults with the bank; the bank really manages these things?

LORD COBBOLD: Yes. In fact, in practice the government will decide on their requirements. The practice is for the bank to be considering all the time how we might best meet the government's needs, what would be a suitable moment for a conversion, what would be a suitable moment for moving into the long-term market, and the normal practice would be for us to say to the government, "Well, it looks as if now would be a good time to deal with that one. We know that

... we left off before lunchtime, we were talking about the subjects which you put under section 4 here, and one of them -- I will not necessarily take them in order -- one of them is the relationship of debt management to monetary policy, and I asked you a couple of questions about that and I would like to ask you a couple more.

In the handling of government issues, could you give us a brief run-down on the curriculum that is used for getting new government data to the public?

LORD COBBOLD: Could you develop that question a little bit? The curriculum that is used --

COMMISSIONER LEMAN: I understand that the government primarily takes the initiative in this deal and decides how much it needs and consults with the bank; the bank really manages these things?

LORD COBBOLD: Yes. In fact, in practice the government will decide on their requirements. The practice is for the bank to be considering all the time how we might best meet the government's needs, what would be a suitable moment for a conversion, what would be a suitable moment for moving into the long-term market, and the normal practice would be for us to say to the government: "Well, it looks as if now would be a good time to deal with that one. We know that

your requirements are such and such and we would suggest making a move now," or, alternatively, "Now doesn't look like a good time and we will carry on on short-term financing for a while and it would probably be better to make it next January or next February," and we should then agree on that general principle with the government and they would say, "O.K., carry on and let us know what specific suggestions you have," or alternatively they might say, "We would rather leave it for a bit and not deal with it until a bit later." We should then get on with our initial discussions with the government brokers and make up our minds what sort of financing is the most appropriate in all the circumstances and then discuss it further with the government and eventually, when we agreed to the general lineup of what we wanted to do, the governor of the bank would have a meeting on the final day with the government brokers, settle what terms were appropriate and advise the treasury to that effect, and the thing would go ahead.

COMMISSIONER LEMAN: Is the relationship with the government brokers primarily between them and the bank or between them and the treasury?

LORD COBBOLD: Between them and the bank entirely; it is an operational relationship. The treasury don't operate in that. The treasury are responsible and, of course, are the determining voice in policy, but on the operational side they leave that entirely to the bank and the relations with the government broker are considered -- and are, indeed -- operational relations.

your requirements are such and such and we would suggest making a new one," and alternatively, "we [illegible] had a bad time [illegible] financing for a while and it would probably be better to make it next January or next February," and we should then agree on that general principle with the government and they would say, "O.K., carry on and let us know what specific suggestions you have," or alternatively they might say, "We would rather leave it for a bit and not deal with it until a bit later." We should then get on with our initial discussions with the government brokers and make up our minds what sort of financing is the most appropriate in all the circumstances and then discuss it further with the government and eventually, when we agreed to the general lineup of what we wanted to do, the governor of the bank would have a meeting on the final day with the government brokers, settle what terms were appropriate and advise the treasury to that effect, and the thing would go ahead.

COMMISSIONER LEMAN: Is the relationship with the government brokers primarily between them and the bank or between them and the treasury?

LORD CROMER: Between them and the bank entirely; it is an operational relationship. The treasury don't operate in that. The treasury are responsible and, of course, are the determining voice in policy, but on the operational side they leave that entirely to the bank and the relations with the government brokers [illegible] operational relations.

COMMISSIONER LEMAN: There is a reference in the short statement you gave on this subject before lunch, too, to the fact that the bank had never tried to change or counteract a strong market situation. However, how far short of that has it been the practice in England to try to influence relationships between short rates and long rates, that sort of action, along the whole thing?

LORD COBBOLD: The short rates, as I was saying earlier, really are directly governed by bank rates. The Bank of England certainly does have a very definite and conscious effect on short-term rates. On long-term rates I don't really think I can use a better phrase than the phrase I used earlier, to nudge the market in one direction or another. That is to say, in the case of a new issue or in the case of the prices that we are currently fixing for loan sales, we might on certain occasions touch ahead of the market or touch behind the market just to give a slight indication, but we should never, as I say, attempt to counteract or reverse the real market tendency to move the market in one direction or the other, partly because the movement can be so large and one might find one's self merely bolstering and feeding a speculative situation, but also for policy reasons we feel on the whole it is better to let the market broadly find its level.

COMMISSIONER LEMAN: Well, there is one more question I would like to ask you on that specific subject, and that is some people have explained to us that they thought there could be some effectiveness from a monetary

[illegible] to try to influence relationships between short rates and long rates, that sort of action, along the whole string?

LORD COBBOLD: The short rates, as I was saying earlier, really are directly governed by bank rates. The Bank of England certainly does have a very definite and decisive effect on short-term rates. On long-term rates I don't really think I can use a better phrase than the phrase I used earlier, to nudge the market in one direction or another. That is to say, in the case of a new issue or in the case of one point that we are currently fixing for loan sales, we might on certain occasions go in front of the market or trail behind the market just to give a slight indication, but we should never, as I say, attempt to counteract or reverse the real market tendency to move the market in one direction or the other, partly because the movement can be so large and one might find one's self merely bolstering up [illegible] a speculative [illegible], but also for other reasons. [illegible] it is better to let the market find [illegible] its level.

COMMISSIONER [illegible]: Well, there is one more question I would like to ask you on that specific subject and that is some people have [illegible] that they

policy standpoint in debt management, what they would call countering debt management technique. Could you tell us what your attitude is on this score?

LORD COBBOLD: Well, the main answer to that in our case -- and I am purely talking of our case and if I understand correctly what is meant by that -- is that we are always a bit up against it since the war, and as I was explaining earlier, we have maturities every year and we haven't nearly the amount of flexibility that one would like to have and there are many occasions I think when one would like to stand off the market for three years or, alternatively, to try and fund more among short-term debt ahead of time. So far as the United Kingdom is concerned, we have to some extent been the creature of the post-war indebtedness because of very frequent maturities and we haven't had quite the flexibility that would be ideal.

COMMISSIONER LEMAN: But assuming that you had the leeway, do you consider that that is an entirely effective tool -- and I am talking of the idea of shortening and lengthening the average debt outstanding as a monetary policy instrument?

LORD COBBOLD: I should always have a strong predilection for lengthening in almost all circumstances. I can see the advantage of standing over for a time to allow that to have its effect on supply and demand, I can see the advantage in coming in with a big government issue from time to time, it may have this effect on supply and demand, but in terms of short and long I would always, with a very heavy government

[illegible]

call counter [illegible]

tell us what [illegible]

LORD COBBOLD: Well, the main answer to that in my [illegible] if I understand correctly what is meant by that -- is that we are always a bit up against it since the war, and as I was explaining earlier, we have maturities every year and we haven't really the amount of flexibility that one would like to have, and there are many occasions I think when one would like to stand off the market for three years or, alternatively, to try and fund more among short-term debt ahead of time. So far as the United Kingdom is concerned, we have to some extent been the creature of the post-war indebtedness because of very frequent maturities and we haven't had quite the flexibility that would be ideal.

COMMISSIONER [illegible]: But assuming that you had the leeway, do you consider that that is an entirely effective tool -- and I am talking of the idea of shortening and lengthening the average debt outstanding -- as a monetary policy instrument?

LORD COBBOLD: I should have said I have a strong predilection for lengthening in almost all circumstances. I can see the advantage of standing over for a time to allow that to have its effect on supply and demand, I can see the advantage in coming in with a big government issue from time to time, it may have this effect on supply and demand, but in terms of [illegible] and long I would always, with a very heavy [illegible]

debt, be in favour of lengthening wherever I see the possibility.

COMMISSIONER LEMAN: Those who believe in this tool believe in it because it can influence liquidity in the economy?

LORD COBBOLD: Yes. Well, there again I am afraid I am talking very much from the United Kingdom and our trouble is -- at least all the time I have been concerned with it -- that we have had excess liquidity.

COMMISSIONER MACKINTOSH: I have one or two questions, Lord Cobbold, in respect to the effects of monetary policy on the domestic market. In your memo you have quite a strong clear statement to make and agreed with the general line of policy on credit controls and that the inventory policy excluded this in the post-war period. Now, I find that the Radcliffe Committee said almost the same thing but negatively and with a rather more optimistic indication, it seems to me; they said that by their nature monetary measures are incapable by themselves of having an effect sufficiently prompt and far-reaching for their purposes unless applied with a vigour which itself creates a major emergency. Do you think there is a real difference there in your --

[illegible]

[illegible]

[illegible]

[illegible]: Yes, Sir, there again I am afraid I am talking very much from the United Kingdom and our trouble is -- at least all the time I have been concerned with it -- that we have had excess liquidity.

COMMISSIONER MACINTOSH: I have one or two questions, Lord Cobbold, in respect to the effects of monetary policy on the domestic market. In your memo you have quite a strong clear statement to make and agreed with the general line of policy on credit [illegible] in the post-war period. Now, I find that the Radcliffe Committee said almost the same thing but negatively and with a rather more emphatic indication, it seems to me; they said that by their nature monetary measures are incapable by themselves of having an effect sufficiently prompt and far-reaching for their purposes unless applied with a vigour which itself creates a major emergency. Do you think there is a real difference there in your --

LORD COBBOLD: There is perhaps a difference of emphasis. I would agree -- and perhaps you saw my evidence before the Radcliffe Committee -- that the only time that monetary policy in terms of bank rate or direct credit controls has a strong effect on the economy is when it is applied pretty vigorously, and probably in connection with some other fiscal measures. I think I would still stick to my rather more positive setting out of approximately the same argumentation which as you say the Radcliffe Committee set out, a little more negatively.

COMMISSIONER MACKINTOSH: There is a matter which really touches on debt management which bothers me a bit. With a vigorous monetary policy which produces quite sharp changes in rates, do you not, to some extent, destroy government bonds as an investment vehicle?

LORD COBBOLD: Well, to me the real factor tending to destroy government bonds as an investment is lack of confidence which has often a greater effect on the long term market. This was, as a matter of fact, one of the particular points on which I personally had a great deal of argument with some members of the Radcliffe Committee -- not the committee as a whole. The argument was advanced rather freely in one or two quarters that it would be a good thing to go into the market in a big way to depreciate long term government securities to put the rate up. I have always held that overt and direct action by the authority to depreciate long

term government securities in a big way would have that very effect of destroying governmental credit, and the bank has always maintained that that would be a bad thing to do, quite apart from whether it was practical or not, for that very reason.

In the short market where the movements of bank rate have an immediate and rather more drastic effect, it does not have that result. That is because short bonds are held by professionals, the discount market and bankers, and they, so to speak, recognize that this is one of the ups and downs and that they are liable to those fluctuations; when it goes one way it will be beneficial, and when it goes the other way they will lose a bit. That is all recognized, and the same consideration does not apply. It does apply very much in the long term market, but, I repeat, the general confidence and the feeling that someone is doing something about it is more important than the actual movements of rate there.

I, for one, would always set my face against the authorities deliberately reducing the value of long term government securities by large amounts because they are held by the general public, and I believe that would have a very deleterious effect on the government credit.

COMMISSIONER MACKINTOSH: Do you feel the current techniques of monetary control, as we know them, are adequate?

LORD COBBOLD: Well, I think one should

long government securities in a big way would have that very effect of destroying governmental credit, [illegible] a bad thing to do, quite apart from whether it was practical or not, for that very reason.

In the short market where the movements of bank rate have an immediate and rather more drastic effect, it does not have that result. That is because short bonds are held by professionals, the discount market and bankers, and they, so to speak, recognize that this is one of the ups and downs and that they are liable to these fluctuations; when it goes one way it will be beneficial, and when it goes the other way they will lose a bit. That is all recognized, and the same consideration does not apply. It does apply very much in the long term market, but, I repeat, the general confidence and the feeling that someone is doing something about it is more important than the actual movements of rate there.

I, for one, would always set my face against the authorities deliberately reducing the value of long term government securities by large amounts because they are held by the general public, and I believe that would have a very deleterious effect on the government credit.

COMMISSIONER MACKINTOSH: Do you feel the current techniques of monetary control, as we [illegible]

LORD COBBOLD: Well, I think one should

always be open to new ideas and new thoughts. We introduced the special deposit arrangement quite recently, as you know, and I should say we have made quite a number of refinements without any startling changes over the past twelve years. Indeed, in the handling of the debt management side it is probably new to go as far as nudging it in one direction or the other. That, I think, was not done before recent years. We have been a little more positive on that.

COMMISSIONER MACKINTOSH: Previously it would be largely a bills only policy?

LORD COBBOLD: Yes, almost entirely. As I say, on the question of near banks I think we are very far from the end of the story there, and I would have thought that that was the direction in which changes or refinements over the next period would probably be necessary.

COMMISSIONER MACKINTOSH: Do you think a policy of freezing advances is an effective way, or that it should not be used except in fairly extreme circumstances?

LORD COBBOLD: I dislike freezing except in extreme circumstances. I think that whatever means are used there is probably an advantage in damping down a bit when you see things going up too fast, and I would imagine, whichever particular technique is used, central bankers would still think it wise to use some dampening effect if they saw bank advances going upwards too fast. I think the

[illegible]

[illegible]

[illegible]

a number of refinements within, say stretching

[illegible] over the past twelve years. Indeed,

in the handling of the debt management side it is probably new to go as far as nudging it in one direction or the other. That, I think, was not done before recent years. We have been a little more positive on that.

[illegible]

it would be largely a bills only policy?

LORD COBBOLD: Yes, almost entirely. As I say, on the question of your banks I think we are very far from the end of the story there, and I would have thought that that was the direction in which changes or refinements over the next period would probably be necessary.

COMMISSIONER MACKINTOSH: Do you think a policy of freezing advances is an effective way or that it should not be used except in fairly extreme circumstances?

LORD COBBOLD: I believe freezing, except in extreme circumstances. I think that whatever means are used there is probably an advantage in bringing down a bit when you see banks going up too fast, and I would imagine, whatever particular technique is used, central bankers would still think [illegible] to use some dampening effect if they saw [illegible] going upwards too fast. I think the

question of pace is far more important than the question of volume there.

COMMISSIONER MACKINTOSH: Freezing, to use that word again, is more or less carried out by agreement with the banks?

LORD COBBOLD: Yes. Of course, we have a great complication there in that we use almost entirely an overdraft system. People have limits to their overdrafts, and these overdraft limits, taking a very broad average, are used to the extent of about 60 per cent, or perhaps a little bit more, so there is always a margin of somewhere between 30 per cent and 40 per cent of the limits that customers can draw on. This means that for six months or twelve months the banks can do nothing about it, and that has added considerably to the difficulty of making changes in monetary policy and in making our requests to banks to limit advances effective quickly.

There is no doubt from that point of view that the system of fixed bank loans makes it easier for the policy to have an immediate effect, because where a limit has been given that limit is normally good for six months or good for twelve months, and there is very little that the bank lenders can do about it until the expiry of that period. I think that has certainly been, I think you could call it, a weakness in the system.

COMMISSIONER MACKINTOSH: Another weakness that you imply is the lag in effect. I think you say

question of how far [illegible]

of [illegible].

COMMISSIONER MACKINTOSH: Freezing, to use that word again, is more or less carried out in [illegible]?

LORD COBBOLD: Yes. Of course, we have a great complication there in that we use almost entirely an overdraft system. People have limits to their overdrafts, and these overdraft limits, taking a very broad average, are used to the extent of about 60 per cent, or perhaps a little bit more, so there is always a margin of something between 30 per cent and 40 per cent of the limits that customers can draw on. That means that for six months or twelve months the banks can do nothing about it, and that has added considerably to the difficulty of making changes in monetary policy and in making our requests to banks to limit advances effective quickly.

There is no doubt from that point of view that the system of fixed term loans makes it easier for the policy to have an immediate effect, because where a limit has been given that limit is normally good for six months or good for twelve months, and there is very little that the bank [illegible] can do about it until the expiry of that period. I think that has certainly been, I think you could call it, a weakness in the system.

COMMISSIONER MACKINTOSH: Another weakness that you mention is the lag in effect. I think you say

at some place that it may take some six months before there is a --

LORD COBBOLD: That has been our general experience. People have commitments and arrangements, and it does not make any sense for a banker to go to his big industrial customer and say: "Well, you have got to reduce your bank borrowing by 25 per cent by next week". That would mean either throwing stocks onto the market in a ridiculous way, or interrupting some development scheme that was three-quarters of the way through. It does take a certain amount of time. I do not say that in a moment of absolute crisis you could not bring it about more quickly than that, because you could, but that would be at the expense of doing quite a bit of damage to the system.

COMMISSIONER MACKINTOSH: Again, borrowing is like the bill portfolio. Somebody's loan is always there. The credit term is always coming up for consideration.

LORD COBBOLD: As I say, there are always programmes half way through, and there is the level of stocks people keep over that period of the year. A violent change brought about by some monetary direction can often do a good deal of harm. As I say, I do not think it can always be avoided, and there are occasions when you have to force it. For instance, in September, 1957 -- I think that is the correct date -- when we jumped from 5 to 7 per cent and had a rather major crisis,

at some place that it may take some six months before there is a --

LORD CROMER: That has been our general experience. People have commitments and arrangements, and it does not make any sense for a banker to go to his big industrial customer and say: "Well, you have got to reduce your bank borrowing by 25 per cent by next week". That would mean either throwing stocks onto the market in a ridiculous way, or interrupting some development scheme that was three-quarters of the way through. It does take a certain amount of time. I do not say that in a moment of absolute crisis you could not bring it about more quickly than that, because you could, but that would be at the expense of doing quite a bit of damage to the system.

COMMISSIONER MACDONALD: Again, borrowing is like the bill portfolio. Somebody's loan is always there. The credit term is always coming up for consideration.

LORD CROMER: As I say, there are always programmes half way through, and there is the level of stocks people keep over that period of the year. A violent change brought about by some monetary direction can often do a good deal of harm. As I say, I do not think it can always be avoided, and there are occasions when you have to force it. For instance, in September, 1957 -- I think that is the correct date -- when we jumped from 5 to 7 per cent and had a rather major crisis.

it acted rather more quickly but it probably created a good deal of confusion in the process. Making these drastic changes is not a thing that one likes to do frequently.

COMMISSIONER MACKINTOSH: It is relatively easy to see what you might call the financial results of monetary policy and some of the effects on international positions, but any inquiries that have been made into the effect on the amount of real investment seem to me always to be disappointing. It is very hard to fix on results. Have you reached any conclusions on this?

LORD COBBOLD: I would agree that that is very difficult, indeed. After all, what the businessman, whether he is expanding or buying more stock, is thinking about is what the general position is going to be in three months, six months, or twelve months, and he is probably more bothered about that than about particular credit actions which the central bank may be taking at a specific moment. Therefore, what he is really interested in, I think, is seeing whether the actions taken by the authorities are such as to promote activity in the forthcoming period, and he is looking at things much more generally than at a specific change in rates.

I would make one observation which may be relevant to that. Broadly speaking, I think it is true, in the ten or twelve years after the war there was such a pressure towards expansion generally, and such inflationary pressures generally, that unless

[illegible]

COMMISSIONER MACKINTOSH: It is relatively easy to see what you might call the financial results of monetary policy and some of the effects on international positions, but any inquiries that have been made into the effect on the amount of real investment seem to me always to be di appointing. It is very hard to fix on results. Have you reached any conclusions on that?

LORD COBBOLD: I would agree that that is very difficult, indeed. After all, what the businessman, whether he is expanding or buying more stock, is thinking about is what the general position is going to be in three months, six months, or twelve months, and he is probably more bothered about that [illegible] central bank may be fixing at a specific moment. Therefore, what he is really interested in, I think, is seeing whether the actions taken by the authorities are such as to promote activity in the forthcoming period, and he is looking at things much more generally than at a specific change in rates.

I would make one observation which may be relevant to that. Broadly speaking, I think it is true, in the ten or twelve years after the war there was such a pressure towards expansion generally [illegible]

there were very heavy movements the big business people were not tremendously concerned about changes in interest rates. I think everybody becomes concerned when they go above a certain level. I mean, a 7 per cent bank rate in England certainly has an effect, I would say, on the big industrial developers, but a change from $4\frac{1}{2}$ to 5 per cent, or even from $4\frac{1}{2}$ to $5\frac{1}{2}$ per cent in those years of expansion had a rather limited effect.

On the other hand, if you get to a general economic situation where profits are being squeezed a bit, where turnover may be on the up but profit is more difficult, which I think has been the more recent situation, I think this then becomes much more of a factor. I would risk an opinion that in the past two or three years people have looked much more at their borrowing charges than they did in the preceding twelve years. I think people, on the whole, have been fairly conscious of borrowing charges -- again, I am talking about the United Kingdom -- in the last two or three years when it has become more difficult to make profit.

COMMISSIONER MACKINTOSH: As I think you found in England, and certainly on this continent, it proved fairly hard to get businessmen to say how they have been affected by interest rates. Perhaps they do not know, but one does not like to be forced into the position where one accepts that actions are the same at high rates as at low rates.

there were very heavy movements the big business people were not tremendously concerned about changes in interest rates. I think everybody becomes concerned when they go above a certain level. I mean, a 7 per cent bank rate in England certainly has an effect, I would say, on the big industrial developers, but a change from 4½ to 5 per cent, or even from 4½ to 5½ per cent in those years of expansion had a rather limited effect.

On the other hand, if you get to a general economic situation where profits are being squeezed a bit, where turnover may be on the up but profit is more difficult, which I think has been the more recent situation, I think this then becomes much more of a factor. I would risk an opinion that in the past two or three years people have looked much more at their borrowing charges than they did in the preceding twelve years. I think people, on the whole, have been fairly conscious of borrowing charges -- again, I am talking about the United Kingdom -- in the last two or three years when it has become more difficult to make profit.

COMMISSIONER MACKINTOSH: As I think you found in England, and certainly on this continent, it proved fairly hard to get businessmen to say how they have been affected by interest rates. Perhaps they do not know, but one does not like to be forced into the position where one accepts that actions are the same at high rates as at low rates.

LORD COBBOLD: Yes. As I say, if profits are easy and everything is on the up and up, then I think it is possible that the level of rates does not have a tremendous influence until it gets very high. When interest rates get very high they inevitably have an influence. In another period when profitability is less easy interest rates come to have a definite effect, and people look at them very much more.

COMMISSIONER GIBSON: Perhaps I may ask another question along these lines. When the Bank of England changes its policy by announcing a change in the bank rate -- a sizeable upward change in the bank rate -- would you say that this induces changed expectations in the business community which in turn may be the reason for the change in the demand for money rather than an actual change in the cost of money induced by the change in the bank rate?

LORD COBBOLD: The bank rate has a very strong traditional -- or whatever you like to call it -- it has still a strong effect in England. I do not know whether it has here. It is one of the things that get headlines in the evening newspapers, if I may put it like that. A sharp upward change in the bank rate does bring home to the public, I think, more than any other form of official statement or exercise that there are dangerous waters ahead.

COMMISSIONER GIBSON: And by "public" you mean the business community?

LORD COBBOLD: The very wide general public.

are easy and everything is on the up and up, then I think it is possible that the level of rates does not have a tremendous influence until it gets very high. When interest rates get very high they inevitably have an influence. In another period when profitability is less easy interest rates come to have a definite effect, and people look at them very much more.

COMMISSIONER GIBSON: Perhaps I may ask another question along these lines. When the Bank of England changes its policy by announcing a change in the bank rate -- a sizeable upward change in the bank rate -- would you say that this induces changed expectations in the business community which in turn may be the reason for the change in the demand for money rather than an actual change in the cost of money induced by the change in the bank rate?

LORD COBBOLD: The bank rate has a very strong traditional -- or whatever you like to call it -- it has still a strong effect in England. I do not know whether it has here. It is one of the things that get headlines in the evening newspapers, if I may put it like that. A sharp upward change in the bank rate does bring home to the public, I think, more than any other form of official statement or exercise that there are dangerous waters ahead.

COMMISSIONER GIBSON: And by "public" you mean the business community?

LORD COBBOLD: The very wide general public.

It is a curious thing, but that is how it is. You can go out and make statements about the difficult situation that is facing us, and all that sort of thing, and everybody is inclined to shrug that off a little bit and to say: "We have heard that before", but if you put up the bank rate from 4 per cent to 5 per cent then that has an immediate effect on a wide section of the community. I am not saying that that makes any particular sense, or whether it is a good or a bad thing, but that is a fact in my country.

COMMISSIONER GIBSON: And, therefore, the effect of an upward change in the bank rate on expectations would be more important in causing people to reduce their expenditures rather than the actual increase in the cost of money?

LORD COBBOLD: I think that that is so.

COMMISSIONER GIBSON: Do you think that that kind of thinking applies on the downgrade, to a reduction in the bank rate?

LORD COBBOLD: I would think so. I would have to digress a little from that. Whenever we have had to put the bank rate up one of the things I have always said to myself is: "How are we going to get it down without appearing to relax too quickly?". Obviously, you do not want to live with a 7 per cent bank rate for a long time. I do not think anybody will dispute that. Therefore, when you go up to 7 per cent, one of the things you have to ask yourself is: "How on earth am I going to get away from this without giving an undue impression

It is a curious thing, but that is how it is. You can go out and make statements about the difficult situation that is facing us, and all that sort of thing, and everybody is inclined to shrug that off a little bit and to say: "We have heard that before", but if you put up the bank rate from 4 per cent to 5 per cent then that has an immediate effect on a wide section of the community. I am not saying that that makes any particular sense, or whether it is a good or a bad thing, but that is a fact in my country.

[illegible]

the effect of an upward change in the bank rate on expectations would be more important in causing people to reduce their expenditures rather than the actual increase in the cost of money?

LORD COBBOLD: I think that that is so.

COMMISSIONER GIBSON: Do you think that kind of thinking applies on the downgrade, to a reduction in the bank rate?

LORD COBBOLD: I would think so. I would have to digress a little from that. Whenever we have had to put the bank rate up one of the things I have always said to myself is: "How are we going to get it down without appearing to relax too quickly?". Obviously, you do not want to live with a 7 per cent bank rate for a long time. I do not think anybody will dispute that. Therefore, when you go up to 7 per cent, one of the things you have to ask yourself is: "How on earth am I going to get away from this without giving an undue impression

that everything is now easy?", and one of our difficulties has been to put that across. We try to come down, as you know, gradually rather than with a bump, and while doing so make loud noises to the effect that while things are not in a state of crisis any more, please do not think that everything is now easy. We have not always been wholly successful in getting that across. It certainly does affect public judgment both ways.

COMMISSIONER GIBSON: Also with respect to this question of how monetary policy works, some students of this matter say that it is more the availability of money than it is the price of money that is important when money is getting tighter or easier. Would you care to make any comments on that?

LORD COBBOLD: I would go back to what I was saying to Mr. Mackintosh. In times of boom, I think, that is certainly true, when profits look easy. I would say that during the ten years after the war it was availability that probably bothered people more than price. I think as soon as you get into a more difficult profit situation then the cost of money becomes very much more a consideration.

that everything is now easy, and one of our [illegible] has been to put that across. We try to come down, as you know, gradually rather than with a bump, and while doing so make loud noises to the effect that while things are not in a state of crisis any more, please do not think that everything is now easy. We have not always been wholly successful in getting that across. It certainly does affect public judgment both ways.

[illegible]

to this question of how monetary policy works, some students of this matter say that it is more the availability of money than it is the price of money that is important when money is getting tighter or easier. Would you care to make any comments on that?

LORD COBBOLD: I would go back to what I was saying to Mr. Mackintosh. In times of boom, I think, that is certainly true, when profits look easy. I would say that during the ten years after the war it was availability that probably bothered people more than price. I think as soon as you get into a more difficult profit situation then the cost of money becomes very much more a consideration.

I would always think that when you get to high levels -- for example, the 7 per cent bank rate in the U.K. -- that is a very considerable consideration in pure cost. But if you are talking of a difference between a 4½ per cent and a 5 per cent bank rate and a corresponding difference in the availability, on the whole I would say that in a time of great prosperity and rather inflationary pressures that margin of availability is more important than that margin of interest rate cost.

COMMISSIONER GIBSON: So that availability in the United Kingdom is not by any means fully reflected in changed costs or interest charges?

LORD COBBOLD: No, not always. Through that period, in a way, we have been nust as much concerned to ask the banks to go steady in their lending policy, to introduce a special deposits mechanism to reduce the availability,as we have to put up the cost of it. We have tried to do the two together, to a certain extent.

COMMISSIONER GIBSON: You have never had any legal ceilings on interest rates, or that sort of thing?

LORD COBBOLD: No.

COMMISSIONER GIBSON: But, in fact, the interest rates structure has not gone up as it would have gone up in a purely competitive market in tight money periods?

LORD COBBOLD: Probably not, no, that is

I would always think that when you get to high levels -- for example, the 7 per cent bank rate in the U.K. -- that is a very considerable consideration in pure cost. But if you are talking of a difference between a 4½ per cent and a 5 per cent bank rate and a corresponding difference in the availability, on the whole I would say that in a time of great prosperity and rather inflationary pressures that margin of availability is more important than that margin of interest rate [illegible]

COMMISSIONER GIBSON: So that availability in the United Kingdom is not by any means fully reflected in changed costs or interest charges?

LORD COBBOLD: No, not always. Through that period, in a way, we have been just as much concerned to ask the banks to go steady in their lending policy, to introduce a special deposits mechanism to reduce the availability, as we have to put up the cost of it. We have tried to do the two together, to a certain extent.

COMMISSIONER GIBSON: You have never had any legal ceilings on interest rates, or that sort of thing?

LORD COBBOLD: No.

COMMISSIONER GIBSON: But, in fact, the interest rates structure has not gone up as it would have gone up in a purely competitive market in tight money periods?

LORD COBBOLD. Probably not, no, that is

probably true.

COMMISSIONER GIBSON: Would you care to say anything about how tight money affects consumer decisions in addition to business decisions? Is this an important factor, do you think?

LORD COBBOLD: It is a very important factor. I should have thought the sort of considerations were normally the same. That is to say, I would think that the bank rate as a warning bell affects consumer decisions quite considerably.

COMMISSIONER GIBSON: These are decisions to buy automobiles, houses and that sort of thing?

LORD COBBOLD: Yes. If I may repeat myself, I am not saying whether it is right or wrong, or sensible or not sensible, but there is no doubt with the British public that a certain sharp rise in the bank rate does more than a great number of speeches by a great number of people, to have an effect on the public mentality that things are rather difficult and that they had probably better go a bit slow in their spending. That is a traditional fact, and it seems to have that effect. Perhaps it is more psychological than real, in some ways. If I may put that a little more pictorially, so to speak, if you went either to a rather superior business dinner party in Birmingham or if you went in the evening around to a public house on the outskirts of any town in England, people would know that the bank rate had been put up that day, and would be interested in it, and that would be a subject of general conversation; and the chap either at the

probably lower.

COMMISSIONER GIBSON: Would you care to say anything about how tight money affects consumer decisions in addition to business decisions? Is this an important factor, do you think?

LORD COBBOLD: It is a very important factor. I should have thought the sort of considerations were normally the same. That is to say, I would think that the bank rate as a warning bell affects consumer decisions quite considerably.

COMMISSIONER GIBSON: [illegible] to buy automobiles, houses and that sort of thing?

LORD COBBOLD: Yes. If I may repeat myself, I am not saying whether it is right or wrong, or sensible or not sensible, but there is no doubt with the British public that a certain sharp rise in the bank rate does more than a great number of speeches by a great number of people, to have an effect on the public mentality that things are rather difficult and that they had probably better go a bit slow in their spending. That is a traditional fact, and it seems to have that effect. Perhaps it is more psychological than real, in some ways. If I may put that a little more pictorially, so to speak, if you went either to a rather superior business dinner party in Birmingham or if you went in the evening around to a public house on the outskirts of any town in England, people would know that the bank rate had been put up that day, and would be interested in it, and that would be a subject of general conversation; and the chap either at the

business dinner or around at the public house would say "Oh, things are obviously a bit tricky".

COMMISSIONER GIBSON: They would be thinking of it in terms of their spending and savings?

LORD COBBOLD: They would be wondering how that is going to affect them.

COMMISSIONER GIBSON: So that psychologically this is very important, in addition to the actual impact on the financial world.

LORD COBBOLD: Psychologically I would maintain this remains particularly important, especially in the case of a large and rather dramatic move.

COMMISSIONER GIBSON: Do you like this system where you have, as a matter of custom, the lending rates and deposit rates of the clearing banks almost associated with the bank rate?

LORD COBBOLD: We find it very convenient, because it means we have been able to operate on the cost of lending quite directly. It suits us.

COMMISSIONER GIBSON: Does it fit into other kinds of rates that affect spending generally?

LORD COBBOLD: Building deposit and hire-purchase charges, et cetera, do not necessarily follow a movement of a quarter or half immediately, but if the bank rate and, consequently, banks' lending rates are moving up considerably, surely other rates will move up competitively with them.

COMMISSIONER GIBSON: This extends out to the medium and longer rates to a considerable degree?

business dinner or around at the public house would say "Oh, things are obviously a bit tricky".

[illegible]

thinking of it in terms of their spending and savings?

LORD COBBOLD: They would be wondering how that is going to affect them.

COMMISSIONER GIBSON: So that psychologically this is very important, in addition to the actual impact on the financial world.

LORD COBBOLD: Psychologically I would maintain this remains particularly important, especially in the case of a large and rather dramatic move.

COMMISSIONER GIBSON: Do you like this system where you have, as a matter of custom, the lending rates and deposit rates of the clearing banks almost associated with the bank rate?

LORD COBBOLD: We find it very convenient, because it means we have been able to operate on the [illegible]

COMMISSIONER GIBSON: Does it fit into other kinds of rates that affect spending generally?

[illegible] and hire-purchase charges, et cetera, do not necessarily follow a movement of a quarter or half immediately, but if the bank rate and, consequently, banks' lending rates are moving up considerably, surely other rates will move up competitively with them.

[illegible] to the medium and longer rates to a considerable [illegible]

LORD COBBOLD: To some extent. You often get, as I said earlier, the confidence factor working rather the other way in longer rates, because if long-term government securities have been sagging because there has been a crisis looming and you have not been doing anything about it, if you then do something about it, that will have an effect on the long-term securities.

COMMISSIONER GIBSON: When you mentioned building rates you were thinking of deposit or lending rates?

LORD COBBOLD: I was thinking of their deposit rates, primarily.

COMMISSIONER BROWN: In relation to the bank rate, the lending rate of the banks, you mentioned this morning a margin of 1 to 1½ per cent. This is the widest range?

LORD COBBOLD: No.

COMMISSIONER BROWN: Is one per cent the prime rate?

LORD COBBOLD: I think there are some people who are probably borrowing at a bank rate plus half, a bank rate plus one, which is a normally good rate, and it may go up to bank rate plus 2 or 2½, even. That is the sort of spread.

COMMISSIONER BROWN: Do the banks find this system assists in rationing credit?

LORD COBBOLD: No, I would not say that assists in rationing credit. That is a question of credit-worthiness -- that is, the rate.

COMMISSIONER BROWN: But the banks are still faced with the problem of rationing credit among established borrowers?

LORD COBBOLD: The banks have been faced with that, quite definitely, in meeting the official requests to limit their advances or damp them down. It faces them with a very difficult problem of rationing.

COMMISSIONER BROWN: They cannot do this just by increasing rates?

LORD COBBOLD: No. On occasion we have given some official indication, for example, that we should like to see agricultural finance and export finance maintained, but we would like to see them go slow on hire-purchase and commercial building, and one or two of those general indications. We have tried to avoid that as much as possible.

COMMISSIONER BROWN: Have you made such suggestions as far as rates are concerned?

LORD COBBOLD: No, never. You mean charged more to one group, or less?

COMMISSIONER BROWN: Yes.

LORD COBBOLD: Never.

COMMISSIONER BROWN: It is on a direct rationing basis?

LORD COBBOLD: Yes, rationing in the sense of the sort of speeches the Bank of England have made from time to time -- "We hope you will damp your advances down, but we hope that in that process you will pay due attention to the needs of

COMMISSIONER BROWN: But the banks are still faced with the problem of rationing credit among established borrowers?

LORD COBBOLD: The banks have been faced with that, quite definitely, in meeting the official requests to limit their advances or damp them down. It faces them with a very difficult problem of rationing.

COMMISSIONER BROWN: They cannot do this just by increasing rates?

LORD COBBOLD: No. On occasion we have given some official indication, for example, that we should like to see agricultural finance and export finance maintained, but we would like to see them go slow on hire-purchase and commercial building, and one or two of those general indications. We have tried to avoid that as much as possible.

COMMISSIONER BROWN: Have you made such suggestions as far as rates are concerned?

LORD COBBOLD: No, never. You mean charged more to one group, or less?

COMMISSIONER BROWN: Yes.

LORD COBBOLD: [illegible]

COMMISSIONER BROWN: It is on a direct rationing basis?

LORD COBBOLD: Yes, rationing in the sense of the sort of speeches the Bank of England have made from time to time -- "We hope you will damp your advances down, but we hope that in that process you will pay due attention to the needs of

export and agriculture, and will tend to damp down a bit more on certain other things."

COMMISSIONER BROWN: This relationship between the bank rate and the lending rate has been an old-established custom, and there is no statutory authority for it?

LORD COBBOLD: None at all.

COMMISSIONER BROWN: Can you see any reason against having statutory authority for it?

LORD COBBOLD: I see no necessity for it with us. It is a universal custom -- universal in the U.K., I mean.

COMMISSIONER BROWN: There are two other matters I would like to ask about in a little more detail. Dr. Mackintosh has dealt with the point you made, "that it takes some six months before a switch from easy to tight conditions works" -- and your phrase is -- "right through the system". Does this refer to the banking system or the financial system or the whole country?

LORD COBBOLD: The whole country.

COMMISSIONER BROWN: That is, the effect is fairly rapid throughout the whole country?

LORD COBBOLD: The effect is fairly rapid on the discount market and the short money apparatus generally. In fact, the effect is felt on the next day. The effect is probably felt by the banking machinery within three or four weeks. I was speaking of the time that it takes to get through to effect other expenditure decisions and consumer

export and agriculture, and will tend to damp down a bit more on certain other things."

[illegible]

between the bank rate and the lending rate has been an old-established custom, and there is no statutory [illegible]

LORD COBBOLD: None at all.

COMMISSIONER BROWN: Can you see any reason against having statutory authority for it?

LORD COBBOLD: I see no necessity for it with us. It is a universal custom -- universal in the U.K., I mean.

COMMISSIONER BROWN: There are two other matters I would like to say about in a little more detail. Dr. Mackintosh has dealt with the point you made, "that it takes some six months before a switch from easy to tight condition works" -- and your phrase is -- "right through the system". Does this refer to the banking system or the financial system or the whole country?

LORD COBBOLD: [illegible]

COMMISSIONER BROWN: That is, the effect is fairly rapid throughout the whole country?

LORD COBBOLD: The effect is fairly rapid on the discount market and the short money apparatus generally. In fact, the effect is felt on the next day. The effect is probably felt by the banking machinery [illegible] I was speaking of the time that it takes to get through to effect other expenditure decisions and consumer

decisions.

COMMISSIONER BROWN: One further question on techniques. When the government broker starts to act in the market on one side or the other, in accordance with your wishes, does he take positive action, or is it rather a matter of responding --

LORD COBBOLD: Both. There again, I repeat that we never try and go against a trend, but he will be taking positive action in one or two fields, and positive action in buying for us the next maturing issue. He is always on the lookout for the early maturing issues to help us with a conversion process. In a sense he will be taking positive action on the recent new issues of which the issue department has a large holding, in that he will be seeking opportunities to place that on the market as opportunities occur. You could call that passive action in the sense that he will not push that unless there is a demand, but at the same time he has a positive instruction to get ahead with that as market possibilities allow.

Another function I did not mention is that we try not to let any one stock get out of line with the general run of stocks because of a particular demand or a particular offer of that particular stock, so that we normally keep in the Bank of England issue department quite a big holding of a whole range of government stocks. If one stock for particular reasons -- somebody realizing

decisions.

[illegible]

on techniques. When the government broker starts to act in the market on one side or the other, in [illegible] action, or is it rather a matter of responding --

[illegible]

I repeat that we never try and go against a trend, but he will be taking positive action in one or two fields, and positive action in buying for us the next maturing issue. He is always on the lookout for the early maturing issues to help us with a conversion process. In a sense he will be taking positive action on the recent new issues of which the issue department has a large holding, in that he will be seeking opportunities to place that in the market as opportunities occur. You could call that passive action in the sense that he will not push that unless there is a demand, but at the same time he has a positive instruction to get ahead with that as market possibilities allow.

Another function I did not mention is that we try not to let any one stock get out of line with the general run of stocks because of a particular demand or a particular offer of that particular stock, so that we normally keep in the Bank of England issue department quite a big holding of [illegible]

[illegible]

for an estate duty, or something of that sort -- appeared to be going out of line, the government broker would be prepared to take that stock in against other comparable stocks so as to even out the process.

COMMISSIONER BROWN: In other words, you are operating a yield curve?

LORD COBBOLD: Yes, that would be a passive function, I think really. That is a purely technical market equalization function.

COMMISSIONER BROWN: This is a rather technical point too: does he operate always through jobbers?

LORD COBBOLD: Yes.

COMMISSIONER GIBSON: I have one other question in this area. Lord Cobbold, you have spoken at some length, from time to time, about the relations between the Bank of England and the clearing banks, and about the informal arrangements that are made. I believe this process is called "moral suasion"?

LORD COBBOLD: Yes, that is one description of it.

COMMISSIONER GIBSON: There is a lot of this, I take it, in the U.K. system. Do the banks show any less willingness to co-operate the more frequently they are asked to take special measures to tighten up a little here and put a little more there?

LORD COBBOLD: I think they complain a bit more, but they play along just the same -- up to date,

for an estate duty, or something of that sort -- appeared to be going out of line, the government broker would be prepared to take that stock in against other comparable stocks so as to even out the process.

COMMISSIONER [illegible]: In other words you are operating a yield curve?

LORD COBBOLD: Yes, that would be a passive function, I think really. That is a purely technical market equalization function.

COMMISSIONER BROWN: This is a rather technical point too: does he operate always through [illegible]

LORD COBBOLD: Yes.

COMMISSIONER GIBSON: I have one other question in this area. Lord Cobbold, you have spoken at some length, from time to time, about the relations between the Bank of England and the clearing banks, and about the informal arrangements that are made. I believe this process is called "moral suasion."

LORD COBBOLD: Yes, that is one description of it.

COMMISSIONER GIBSON: There is a lot of this, I take it, in the U.K. system. Do the banks show any less willingness to co-operate the more frequently they are asked to take special measures to tighten up a little here and put a little more there?

LORD COBBOLD: I think they complain a bit more, but they play along just the same -- up to date,

anyway. The real source of friction there is not the frequency, but this near bank question; that is a difficult one.

COMMISSIONER GIBSON: You did hint at this earlier: at times I think you do have a bit of difficulty in undoing a bit of moral suasion. You have asked people to ease up here a little and then have told them not to ease up.

LORD COBBOLD: Undoing moral suasion is not nearly the same difficulty, because it does not get public publicity. The difficulty is undoing the high bank rate, really. If the governor says to the chairman of the clearing banks, "Well, things are a bit easier and you need not bother quite as much as I asked you two or three months ago", that may get diffused a bit, but it does not get the headlines that everything is now easy. Whereas if you were to bring the bank rate down from six to five, that is an immediate general talking point and it has a psychological effect that the crisis is now over and everything is plain sailing.

COMMISSIONER GIBSON: But suasion does enter into it?

LORD COBBOLD: That comes under the first category, and that can be done much more gently and gradually.

COMMISSIONER GIBSON: Even though everybody knows about it?

LORD COBBOLD: Even though everybody knows about it, it is not a thing that goes to the public. That is a thing that would be known about in rather limited financial circles, those that would be interested in it. Again, in press terms, that would be on the financial pages and not on the front page.

COMMISSIONER GIBSON: You did hint at this earlier: at times I think you do have a bit of difficulty in undoing a bit of moral suasion. You have asked people to ease up here a little and then have told them not to ease up.

LORD COBBOLD: Undoing moral suasion is not nearly the same difficulty, because it does not get public publicity. The difficulty is undoing the high bank rate, really. If the governor says to the chairman of the clearing banks, "Well, things are a bit easier and you need not bother quite as much as I asked you two or three months ago", that may get [illegible] that everything is now easy. Whereas if you were to bring the bank rate down from six to five, that is an immediate general talking point and it has a psychological effect that the crisis is now over and everything is plain sailing.

[illegible] into it?

LORD COBBOLD: That comes under the first category, and that can be done much more gently and gradually.

[illegible] knows about it?

LORD COBBOLD: Even though everybody knows about it, it is not a thing that goes to the public. That is a thing that would be known about in rather limited financial circles, those that would be interested in it. Again, in press terms, that would

COMMISSIONER GIBSON: You are quite happy about this method of working with the bank system?

LORD COBBOLD: I can only say it has worked extraordinarily well in the time I have had to cope with it.

COMMISSIONER BROWN: May I ask one more question which is along this line, but slightly off-centre? In Canada some of the provincial governments in recent months and years have been issuing what are referred to as parity bonds which are, in effect, short-term and call paper. I have a clipping from the London Financial Times saying that you have a somewhat similar problem in England with respect to the short-term borrowing of local governments, which is now up in excess of £ 1,000 million, and this is apparently connected with and is creating some problems in connection with the control of short-term money markets. Would you care to comment on this, or are there problems involved, or have you any suggestions as to how it might be dealt with?

LORD COBBOLD: I think that has perhaps arisen a bit more since my time, but it is certainly true that local authority short-term borrowing was going up, I think, rather more than we thought entirely convenient, and we had some fears it might lead to problems later on. Local authorities were taking a great number of short-term deposits at one time. I could not really comment on developments in that in the last 12 months, I am afraid.

THE CHAIRMAN: You have, or you did have at

COMMISSIONER GIBSON: You are quite happy about this method of getting around the same problem?

LORD COBBOLD: I can only say it has worked extraordinarily well in the time I have had to cope with it.

COMMISSIONER BROWN: May I ask one more question which is along this line, but slightly off-centre? In Canada some of the provincial governments in recent months and years have been issuing what are referred to as parity bonds which are, in effect, short-term and sell paper. I have a clipping from the London Financial Times saying that you have a somewhat similar problem in England with respect to the short-term borrowing of local governments, which is now up in excess of £ 1,000 million, and this is apparently connected with and is creating some problems in connection with the control of short-term money markets. Would you care to comment on this, or are there problems involved, or have you any suggestions as to how it might be dealt with?

LORD COBBOLD: I think that has perhaps arisen a bit more since my time, but it is certainly true that local authority short-term borrowing was going up, I think, rather more than we thought entirely convenient, and we had some fears it might lead to problems later on. Local authorities were taking a great number of short-term deposits at one time. I could not really comment on developments in that in the last 12 months, I am afraid.

THE CHAIRMAN: You have, or you did have at

one time, what is known as a capital issues committee. Is that still in existence?

LORD COBBOLD: I cannot remember whether it is statutorily in existence but it is now out of action. I think it still statutorily exists.

THE CHAIRMAN: What was the purpose of that?

LORD COBBOLD: That was definitely rationing long-term issues. You could not make an issue on the long-term market, or on the London market generally, without the permission of the capital issues committee.

THE CHAIRMAN: So it was, in effect, an instrument of monetary policy to that extent?

LORD COBBOLD: Yes, in wide terms.

THE CHAIRMAN: But you found it was unnecessary?

LORD COBBOLD: To some extent it became extremely difficult in post-war conditions. It was, in my own judgment, very necessary in wartime conditions and shortly after the war. As things were freed up generally and controls were removed generally, I think it became increasingly difficult to maintain a financial control when the rationing controls had disappeared.

THE CHAIRMAN: You do not regard it as being a suitable control under ordinary conditions?

LORD COBBOLD: Not really. It became, I think --

THE CHAIRMAN: Under peacetime conditions?

LORD COBBOLD: -- under peacetime and free conditions it really became too easy -- I do not mean by illegitimate means, but by legitimate means to get

one time, what is known as a capital issues committee. [illegible]

LORD COBBOLD: I cannot remember whether it is statutorily in existence but it is now out of action. I think it still statutorily exists.

THE CHAIRMAN: What was the purpose of that?

LORD COBBOLD: That was definitely rationing long-term issues. You could not make an issue on the long-term market, or on the London market generally, without the permission of the capital issues committee.

THE CHAIRMAN: So it was, in effect, an instrument of monetary policy to that extent?

LORD COBBOLD: Yes, in wide terms.

THE CHAIRMAN: But you found it was [illegible]

LORD COBBOLD: To some extent it became extremely difficult in post-war conditions. It was, in my own judgment, very necessary in wartime conditions and shortly after the war. As things were freed up generally and controls were removed generally, I think it became increasingly difficult to maintain a financial control when the rationing controls had disappeared.

THE CHAIRMAN: You do not regard it as being a [illegible]

LORD COBBOLD: Not really. It became, I think --

THE CHAIRMAN: Under peacetime conditions?

LORD COBBOLD: -- under peacetime and free conditions it really became too easy -- I do not mean by illegitimate means, but by legitimate means to get

around it. If they turned you down you could get around it by borrowing outside the country or by borrowing short and having it converted to long later. We found it was the sort of control that runs you into a lot of trouble and a great deal of rather well-justified criticism, and we felt it was not giving results towards the end of its existence.

THE CHAIRMAN: There was a suggestion made in one brief that we have seen that that sort of thing might be useful.

LORD COBBOLD: I think it was useful earlier on, in the immediate post-war stages.

COMMISSIONER MACKINTOSH: It is awfully hard to establish any reasonable priorities.

LORD COBBOLD: It is very difficult unless you have physical controls at the same time.

THE CHAIRMAN: We move then to number 5, which is also the last item: responsiveness of foreign exchange markets to domestic monetary policy; the role of central banks in international co-operation.

around it. [illegible]

around it by borrowing outside the country or by borrowing short and having it converted to long later. We found it was the sort of control that runs you into a lot of trouble and a great deal of rather well-justified criticism, and we felt it was not giving results towards the end of its existence.

THE CHAIRMAN: There was a suggestion made in one brief that we have seen that that sort of thing might be useful.

LORD COBBOLD: I think it was useful earlier on, in the immediate post-war stages.

COMMISSIONER MACKINTOSH: It is awfully hard to establish any reasonable priorities.

LORD COBBOLD: It is very difficult unless you have physical controls at the same time.

THE CHAIRMAN: We move then to number 5, which is also the last item: responsiveness of foreign exchange markets to domestic monetary policy; the role of central banks in international co-operation.

LORD COBBOLD: I think, sir, we have perhaps verged on that once or twice in what we have been saying already, but I would like to make a few more specific points.

Inter-relation between developments in the international field and domestic monetary policy has increased steadily during the past 15 years, with the gradual return, after wartime conditions, to free exchanges. During these 15 years the Bank of England has probably, of all the major central banks, had to concern itself more with the international field because throughout these years balance of payments and foreign exchange troubles have only been just around the corner, and also because sterling has been and is a very important reserve currency. Canada also clearly has a special position in this matter because of the very close contact with the American market and the American rate structure. But, I would say, generally, with the present degree of freedom in trade and money, no central bank can afford to take decisions for domestic reasons only, without any regard to international developments, and any decisions so taken are inevitably harmful to the international currency structure which has been laboriously built up since the war.

One can, I think, to some extent divide the effect of domestic monetary policy on the foreign exchange market into two categories, though those categories overlap one the other. There is the general confidence side and there is the technical side of

movements of short-term money, and so on, in one direction and another. Our experience has been that at the times when a foreign exchange crisis has been looming, strong monetary action, if it is taken, as it several times has been along with other decisions in the fiscal field, has had a very considerable effect on our balance of payments. But, I would underline that it is always confidence, that is to say, the general attitude of overseas markets, overseas bankers and the public overseas generally about the general policy of the United Kingdom, which is the determining and over-riding factor.

I would not say that you can always be certain that a tight monetary policy will react quickly on the foreign exchange position. I would, however, with considerable certainty put the converse of that, that if any authority in a major centre runs a very easy money policy which is much easier than the other major centres are running, for any considerable time, that will certainly have an adverse effect on its foreign exchange position. I think that is quite certainly true.

The confidence factor to which I referred is, I think, particularly true of sterling partly because of the very heavy overseas sterling liabilities which we inherited from the war and partly because sterling with the United States dollar and gold traditionally, and practically today, constitutes one of the main reserve currencies.

I said there was a confidence factor and a

movements of short-term money, and so on, in one direction and another. Our experience has been that at the times when a foreign exchange crisis has been looming, strong monetary action, if it is taken, as it several times has been along with other decisions in the fiscal field, has had a very considerable effect on our balance of payments. But, I would underline that it is always confidence, that is to say, the general attitude of overseas markets, overseas bankers and the public overseas generally about the general policy of the United Kingdom, which is the determining and over-riding factor.

I would not say that you can always be certain that a tight monetary policy will react quickly on the foreign exchange position. I would, however, with considerable certainty put the converse of that, that if any authority in a major centre runs a very easy money policy which is much easier than the other major centres are running, for any considerable time, that will certainly have an adverse effect on its foreign exchange position. I think that is quite invariably true.

The confidence factor to which I referred is, I think, particularly true of sterling partly because of the very heavy overseas sterling liabilities which we inherited from the war and partly because sterling with the United States dollar and gold traditionally, and practically today, constitutes one of the main reserve currencies.

I said there was a confidence factor and a

technical factor. I have dealt with the confidence factor. Then, there are the technical sides; that is to say, the attraction of floating short-term money to the centre which offers higher interest rates. I said earlier these two factors overlap because international short-term money will not move into a centre which offers better interest rates unless people have confidence that that particular centre is going to be able to hold its position and hold its rate; so that, the two interlock. But the technical factors, by and large, I mean mainly the movement of short-term money which is looking for the best remuneration it can find, is helpful often on a very, very short view to re-establish a position, and there have been times in the recent history of the U.K. and sterling where we have put up interest rates sharply, put them above the rates in other centres, with the deliberate intention of attracting some short-term money back which may have left earlier on, and so re-establishing confidence and keeping our reserves at a reasonable level.

On the other hand, those movements of short-term money can become embarrassing and, as in so many instances in monetary policy, one has to weigh advantage against disadvantage. If you have a large volume of short-term money coming in it adds to confidence and it makes your reserves look better. On the other hand, it means a country is nationally bearing a fairly high interest cost and paying that overseas; and also your position is being made to look a good deal better than it is, and the build-up of your

technical factor. I have dealt with the confidence factor. Then, there are the technical sides: that is to say, the attraction of floating short-term money to the centre which offers higher interest rates. I said earlier these two factors overlap because international short-term money will not move into a centre which offers better interest rates unless people have confidence that that particular centre is going to be able to hold its position and hold its rate; so that, the two interlock. But the technical factors, by and large, I mean mainly the movement of short-term money which is looking for the best remuneration it can find, is helpful often on a very, very short view to re-establish a position, and there have been times in the recent history of the U.K. and sterling where we have put up interest rates sharply, put them above the rates in other centres, with the deliberate intention of attracting some short-term money back which may have left earlier on, and so re-establishing confidence and keeping our reserves at a reasonable level.

On the other hand, those movements of short-term money can become embarrassing and, as in so many instances in monetary policy, one has to weigh advantage against disadvantage. If you have a large volume of short-term money coming in it adds to confidence [illegible] On the other hand, it means a country is nationally bearing a fairly high interest cost and paying that overseas; and also your position is being made to look a good deal better than it is, and the build-up of your

reserves by the inflow of what is purely short-term and very volatile money may conceal there are still fundamental things which ought to be dealt with in the economy and may give a misleading impression of good health. That is a point which always has to be watched.

In brackets, there is a double prong to that because not only when your rates are higher than neighbouring centres, or other important centres, do you attract short-term deposit money, but you push away borrowing; that is to say, in a centre like London where a great deal of international borrowing is done all the time, if borrowing is relatively at one time cheaper in London than in Paris or New York or Amsterdam, then a lot of international borrowing will be done in London. The moment you put the rates up in London, that will switch a great deal of that borrowing to Amsterdam, New York or Paris.

The advances and lending side is not quite as important as what is normally known as hot money, the movement of deposits, but it is very important and we have found that moves very quickly. There are these days a great number of very large international corporations who rightly and properly -- it is their business -- look around the markets every day to see where borrowing is cheapest and where deposits get the best remuneration, and there is a lot both of short-term borrowing and deposit which flows around in that way, and in certain circumstances can conceal an unsatisfactory

~~[illegible]~~s by the inflow of what is purely short-term and very volatile money may conceal there are still [illegible] the economy and may give a misleading impression of good health. That is a point which always has to be watched.

In brackets, there is a double prong to that because not only when your rates are higher than neighbouring centres, or other important centres, do you attract short-term deposit money, but you push away borrowing; that is to say, in a centre like London where a great deal of international borrowing is done all the time, if borrowing is relatively at one time cheaper in London than in Paris or New York or Amsterdam, then a lot of international borrowing will be done in London. The moment you put the rates up in London, that will switch a great deal of that borrowing to Amsterdam, New York or Paris.

The advances and lending side is not quite as important as what is normally known as hot money, the movement of deposits, but it is very important and we have found that moves very quickly. There are these days a great number of very large international corporations who rightly and properly -- it is their business -- look around the markets every day to see where borrowing is cheapest and where deposits get the best remuneration, and there is a lot both of short-term borrowing and deposit which flows around in that way, and in certain circumstances can conceal an unsatisfactory

position.

I am not trying to draw any definite conclusion from that, but I am saying that is an extremely important factor which we have watched with very great care in past years.

On the general relationship of internal monetary policy with its external effects, I was very much struck in the 10 years following the war most particularly between the attitude in the United Kingdom and in the United States, and I think perhaps for many of those years the Canadian attitude was more like that of the United States than the United Kingdom. Since the end of the war, of course, for very obvious reasons the United Kingdom has always been concerned with this overseas aspect. We have had very heavy overseas liabilities. We have been in a sense living on a shoestring in terms of foreign exchange. We have been trying to get our exchange controls freed up gradually and get rid of the controls of wartime, but we have had to move slowly and carefully, and we have throughout been extremely conscious of the effect on the foreign exchanges and the effect on overseas opinion about sterling. In my annual visits to the United States, in the first 10 years after the war, I always used to compare notes with my banking friends in the United States and, of course, this question did not occur to them at all, and they were thinking of internal monetary policy during those years entirely in terms of internal boom, internal slump, employment and all the internal things. It is only in recent

I am not trying to draw any definite conclusion from that, but I am saying that is an extremely important factor which we have watched with very great care in past years.

On the general relationship of internal monetary policy with its external effects, I was very much struck in the 10 years following the war and particularly between the attitude in the United Kingdom and in the United States, and I think perhaps for many of those years the Canadian attitude was more like that of the United States than the United Kingdom. Since the end of the war, of course, for very obvious reasons the United Kingdom has always been concerned with this overseas aspect. We have had very heavy overseas liabilities. We have been in a sense living on a shoestring in terms of foreign exchange. We have been trying to get our exchange controls freed up gradually and get rid of the controls of wartime, but we have had to move slowly and carefully, and we have throughout been extremely conscious of the effect on the foreign exchanges and the effect on overseas opinion about sterling. In my annual visits to the United States, in the first 10 years after the war, I always used to compare notes with my banking friends in the United States and, of course, this question did not occur to them at all, and they were thinking of internal monetary policy during those years entirely in terms of internal boom, internal slump, employment and all the internal things. It is only in recent

years -- the past five or six years -- that they have related the internal policy questions to the questions of balance of payments and foreign exchange. I always used to say to Mr. Martin and my other American friends that while I should be very happy to be in their position and not to have to worry about foreign exchange reserves, as they did not in those years, there were at the same time some disadvantages because the fact we have been so near to exchange difficulties, and that everybody is very conscious of the level of reserves, does act as a very quick warning bell on internal policy and internal conditions. That is to say, that in the United Kingdom we have just not been able to allow ourselves the luxury of getting into any considerable trouble on the monetary or fiscal side, because we should have immediately had pretty violent exchange troubles. On the occasions when we have not dealt quickly enough with a developing situation we have very quickly met with exchange difficulties of that sort, whereas, as Mr. Martin and I used to agree, in the early days after the war it was very much more difficult for the Federal Reserve authorities to encourage restraint and to point to things that ought to be done because they had not got this warning bell on foreign exchange difficulties ringing very loud in the ears of the public.

However, that is going back a little on earlier history, and in the last few years that has changed, and I think you would find -- in fact, I am sure we should all find very general recognition around

years -- the last five or six years -- that they have related the internal policy questions to the questions of balance of payments and foreign exchange. I always used to say to Mr. Martin and my other American friends that while I should be very happy to be in their position and not to have to worry about foreign exchange reserves, as they did not in those years, there were [illegible] we have been so near to exchange difficulties, and that everybody is very conscious of the level of reserves, does act as a very quick warning bell on internal policy and internal conditions. That is to say, that in the United Kingdom we have just not been able to allow ourselves the luxury of getting into any considerable trouble on the monetary or fiscal side, because we should have immediately had pretty violent exchange troubles. On the occasions when we have not dealt quickly enough with a developing situation we have very quickly met with exchange difficulties of that sort, whereas, as Mr. Martin and I used to agree, in the early days after the war it was very much more difficult for the Federal Reserve authorities to encourage restraint and to point to things that ought to be done because they had not got this warning bell on foreign exchange difficulties ringing very loud in the ears of the public.

However, that is going back a little on earlier history, and in the last few years that has changed, and I think you would find -- in fact, I am sure we would all find that

the world that internal monetary policy and the movements on the foreign exchanges and balance of payments are very closely interlocked.

I might perhaps, to end my statement on this section, just allude to the very great importance which I have always attached to central banking co-operation. This has a long history. We at the Bank of England have been fortunate enough to have extremely close contacts with the individual central banks throughout the Commonwealth, with the Federal Reserve system in America, and with the European central banks, and it has undoubtedly been of the greatest assistance both in the formation of policy and in the execution of operations. It is, of course, possible to maintain a degree of contact between central banks all the time, which is more difficult, I think, in many ways for the organs of government, because the central banks have a common interest and a common business the whole time and are actually doing a good deal of business together and are probably looking at very similar problems all day and every day. We have made a practice of having not only the top people but a number of executive directors and senior officials travelling around the Commonwealth a great deal, and I think it is probably true to say that there has been no time during the time I have been at the Bank of England when we haven't known broadly what is in the minds of the Bank of Canada, Reserve Bank of Australia, New Zealand, and around the Commonwealth generally, and when they have not known what is in our

[illegible]

I might perhaps, to end my statement of this section, just allude to the very great importance [illegible] co-operation. This has a long history. We at the Bank of England have been fortunate enough to have extremely close contacts with the individual central banks throughout the Commonwealth, with the Federal Reserve system in America, and with the European central banks, and it has undoubtedly been of the greatest assistance both in the formation of policy and in the execution of operations. It is, of course, possible to maintain a degree of contact between central banks [illegible] many ways for the organs of government, because the central banks have a common interest and a common business the whole time and are actually doing a good deal of business together and are probably looking at very similar problems all day and every day. We have made a practice of having not only the top people but a number of executive directors and senior officials travelling around the Commonwealth a great deal, and I think it is probably true to say that there has been no time during the time I have been at the Bank of England when we haven't known broadly what is in the minds of the Bank of Canada, Reserve Bank of [illegible] when they have not known what is in our

mind, and I believe that has been a very beneficial exercise.

The same thing is true of our contacts with the European banks. I think I have already said we have always kept extremely close with the Federal Reserve System in the United States, and I think my Commonwealth colleagues would agree the Bank of England's close relations and connections in Europe, directly with the European central banks and through the Bank of International Settlements have made the services which the Bank of England can render to the Commonwealth central banks considerably greater than they would have otherwise been. We are very close to the European scene, and by the connections which we have maintained with the Commonwealth I think we have been able to keep them pretty well informed about what is going on in Europe generally. These individual contacts are, I think, going on and increasing all the time, and they have since the war been supplemented by the International Monetary Fund meetings, the meetings of the E.P.U. in Europe, and by the continuing meetings of the Bank for International Settlements.

We had in 1961 what was, I think, something of a milestone in the history of central banking co-operation in what are currently known as the Basle arrangements where a number of central banks gave credit facilities to the Bank of England to assist in meeting a wave of speculation, and, in fact, saw that out successfully with the later co-operation of the International Monetary Fund.

nt, and I believe that has been a very beneficial

venture.

The same thing is true of our contacts with the European banks. I think I have already said we have always kept extremely close with the Federal Reserve System in the United States, and I think my Commonwealth colleagues would agree the Bank of England's close relations and connections in Europe, directly with the European central banks and through the Bank of International Settlements have made the services which the Bank of England can render to the Commonwealth central banks considerably greater than they would have otherwise been. We are very close to the European scene, and by the connections which we have maintained with the Commonwealth I think we have been able to keep them pretty well informed about what is going on in Europe generally. These individual contacts are, I think, going on and increasing all the time, and they have since the war been supplemented by the International Monetary Fund meetings, the meetings of the E.P.U. in Europe, and by the continuing meetings of the Bank for International Settlements.

We had in 1961 what was, I think, something of a milestone in the history of central banking co-operation in what are commonly known as the Basle arrangements where a number of central banks gave credit facilities to the Bank of England to assist in meeting a wave of speculation, and, in fact, saw that out successfully with the later co-operation of the International Monetary Fund.

I believe, myself, that those arrangements are a good augury for the future, and show a road which can be pursued with great advantage, and it is certainly my hope that central banking co-operation on those lines will continue and will be intensified.

I think that is what I have to say, sir.

COMMISSIONER LEMAN: Lord Cobbold, there is one little point here that still puzzles me a bit. Earlier you explained to us that you consider a 7 per cent bank rate rather a violent crisis type of action, and that the country would not like to live with that level of rates for a long period. Would you say that the necessity for such action has been brought about by these external factors -- speculative movements of hot money and such?

LORD COBBOLD: I would put it in a slightly different way, sir: I think they have been necessary to counteract something that was wrong in the internal economy, but it was the pressure of overseas opinion and the foreign exchange crisis, if you like to call it that, that made it necessary to introduce the remedy immediately and quite so suddenly and drastically.

COMMISSIONER LEMAN: Because otherwise one would have to conclude that the necessity for doing it was because action had been taken somewhat too late, unless it was an external factor that had come about to force the violent action at one moment.

LORD COBBOLD: There may be sometimes a bit of both in it. I think there have been occasions when one could have avoided more drastic action if some

[illegible] [illegible] which can be pursued with great advantage, and it is [illegible] on those lines will continue and will be intensified.

I think that is what I have to say, sir.

COMMISSIONER LEMAN: Lord Cobbold, there is one little point here that still puzzles me a bit. Earlier you explained to us that you consider a 7 per cent bank rate rather a violent crisis type of action, and that the country would not like to live with that level of rates for a long period. Would you say that the necessity for such action has been brought about by these external factors -- speculative movements of hot money and such?

LORD COBBOLD: I would put it in a slightly different way, sir: I think they have been necessary to counteract something that was wrong in the internal economy, but it was the pressure of overseas opinion and the foreign exchange crisis, if you like to call it that, that made it necessary to introduce the remedy immediately and quite so suddenly and drastically.

COMMISSIONER LEMAN: Because otherwise one would have to conclude that the necessity for doing it was because action had been taken somewhat too late, unless it was an external factor that had come about to force the violent action at one moment.

LORD COBBOLD: There may be sometimes a bit of both in it. I think there have been occasions when one could have avoided more drastic action if some

lesser action had been taken earlier. But, it is also true that once you begin to take action of that sort, unless you can clearly demonstrate that you are taking full and sufficient action, you may do more harm to overseas confidence than good, and therefore you are probably forced to deal with a disease more quickly and more suddenly and drastically by this overseas question than you might choose to do if you were isolated from the rest of the world.

COMMISSIONER LEMAN: Because on relating this to your statement that the court is not concerned with the bank's activities in the foreign exchange end, where the bank acts as agent --

LORD COBBOLD: I said, I thought they were not formally concerned, but at the same time we took strong advantage of the individual director's knowledge.

COMMISSIONER GIBSON: This brings a question to my mind. You rather implied that Great Britain's dependence on the international situation, their low level of reserves and international indebtedness, at times helped them to do the right thing in the monetary field. I see this point very clearly, but would it be fair to say that it also gets you to go further than you wanted to go on certain occasions?

LORD COBBOLD: On certain occasions certainly it was more violent than we should wish. I think it persuaded us -- the authorities or whatever you would like to call us -- that it was necessary to do something. If it had not been for the outside factors one would have thought it more prudent to do it a little more slowly but that would not have done what was necessary in terms of force. There have been one or two occasions like that.

COMMISSIONER GIBSON: You may have acted both more suddenly and in a more restrictive way than you otherwise would like to act?

LORD COBBOLD: I think that is possible.

COMMISSIONER GIBSON: Would you think that this would have anything to do with the slower rate of growth in Great Britain in recent years?

LORD COBBOLD: I think I would hazard a guess that if we had not had the overseas liabilities inherited from the war we would have then proceeded on an even keel very much easier.

COMMISSIONER GIBSON: And probably would have had a higher net rate of growth over the period?

[illegible]

to my mind. You rather implied that [illegible]

dependence on the international situation, their low level of reserves and international indebtedness, at times helped them to do the right thing in the monetary field. I see this point very clearly, but would it be fair to say that it also gets you to go further than you wanted to go on certain occasions?

LORD COBBOLD: On certain occasions certainly it was more violent than we should wish. I think it persuaded us -- the authorities or whatever you would like to call us -- that it was necessary to do something. If it had not been for the outside factors one would have thought it more prudent to do it a little more slowly but that would not have done what was necessary in terms of force. There have been one or two occasions like that.

COMMISSIONER GIBSON: You may have acted both more suddenly and in a more restrictive way than you otherwise would like to act?

LORD COBBOLD: I think that is possible.

COMMISSIONER GIBSON: Would you think that this would have anything to do with the slower rate of growth in Great Britain in recent years?

LORD COBBOLD: I think I would hazard a guess that if we had not had the overseas liabilities inherited from the war we would have then proceeded on an even keel very much easier.

COMMISSIONER [illegible]

have had a higher net rate of growth over the period?

LORD COBBOLD: I think that is right.

COMMISSIONER GIBSON: You say quite a lot about the movements in funds in the freer exchange situation, and I have got the impression that it is a good thing in a way and there are quite a lot of problems about it, too. This, I take it, is the main way in which the central banks are operating today in a practical fashion in trying to lessen or moderate this rapid movement?

LORD COBBOLD: And offsetting it, too. I would say perhaps offsetting more than moderating.

COMMISSIONER GIBSON: Well, this tendency is obviously increasing as the western world is becoming very much more one place from the economic point of view. Are you concerned about the ease with which money can move around, or do you think this is a good thing?

LORD COBBOLD: That depends; I think this is an advantage, but it implies that the leading monetary fiscal authorities must pursue policies not too far out of line with the others or they will be subjected to very violent movements in one direction or the other, and it also means that there must be machinery available, whether through central bank co-operation, plus European arrangements, plus the B.I.S. arrangements and the International Monetary Fund arrangements in order to meet that constant movement and make sure that sudden movement of funds from one place to another will not upset the whole thing.

COMMISSIONER GIBSON: And in this process forward foreign exchange rates play quite an important part?

LORD COBBOLD: I think that is right.

COMMISSIONER GIBSON: You say quite a lot about the movements in funds in the freer exchange situation, and I have got the impression that it is a good thing in a way and there are quite a lot of problems about it, too. This, I take it, is the main way in which the central banks are operating today in a practical fashion in trying to lessen or moderate this rapid movement?

LORD COBBOLD: And offsetting it, too. I would say perhaps offsetting more than moderating.

COMMISSIONER GIBSON: Well, this tendency is obviously increasing as the western world is becoming very much more one place from the economic point of view. Are you concerned about the ease with which money can move around, or do you think this is a good thing?

LORD COBBOLD: That depends; I think this is an advantage, but it implies that the leading monetary fiscal authorities must pursue policies not too far out of line with the others or they will be subjected to very violent movements in one direction or the other, and it also means that there must be machinery available, [illegible] European arrangements, plus the B.I.S. arrangements and the International Monetary Fund arrangements in order to meet that constant movement and make sure that sudden movement of funds from one place to another will not upset the whole thing.

COMMISSIONER GIBSON: And in this process forward foreign exchange rates play quite an important part?

LORD COBBOLD: Yes.

COMMISSIONER GIBSON: Do you think that this is a proper area for central bank intervention?

LORD COBBOLD: There has been a very violent controversy in a number of technical fields and I always hold the opinion that we are much better to keep out of the forward market. I couldn't tell you how that controversy has moved in the last few months.

COMMISSIONER GIBSON: You would rather let the funds move and do what is necessary?

LORD COBBOLD: I am only talking about London again, but my technical experience on that has always been that if you get into that field it is very difficult to get out and you are very likely to find yourself with international speculation on your back and at your cost, and it is very difficult to get out from under. I would much rather let the rate move out and look after itself. However, that is a personal opinion on a considerably controversial subject.

COMMISSIONER GIBSON: Do you think this increasing co-operation among central banks is affecting the importance of the international reserves, gold and key currencies?

LORD COBBOLD: I always feel what is most important in this general question of the international liquidity is confidence. I think international liquidity is probably sufficient at the moment provided people have confidence in the stability of the main reserve currencies.

There is no doubt whatever that these

arrangements which were made, and the subsequent arrangements, have contributed enormously to a growing feeling of confidence that these things are being looked after, which is what the people want to know.

If I may go back a little, you will remember the very considerable upset there was in March of 1961, which was I think due in large measure to the feeling that whereas co-operative arrangements under a more or less regularized pattern had been greatly built up after the war, the moment came in March of 1961 when this seemed to be done without proper consultation and that the arrangements had rather broken down, and we had to come in in a big way to get over that; partly to deal with the immediate problem that there was, but also to re-establish the feeling that the authorities were co-operating and had the thing in hand, and I believe that last year's International Monetary Fund arrangements made a big contribution to that as well.

COMMISSIONER GIBSON: Do you see any serious risk of lack of international liquidity?

LORD COBBOLD: Oh well, there could be in certain circumstances, but it had not bothered me so long as I was in the bank.

COMMISSIONER GIBSON: From what you say I gather that one of the key factors in this picture in your mind would be confidence in the dollar sterling in maintaining that degree of liquidity?

LORD COBBOLD: Yes, confidence in the dollar sterling rate.

arrangements, have contributed enormously to a growing feeling of confidence that these things are being looked after, which is what the people want to know.

If I may go back a little, you will remember the very considerable upset there was in March of 1961, which was I think due in large measure to the feeling that whereas co-operative arrangements under a more or less regularized pattern had been greatly built up after the war, the moment came in March of 1961 when this seemed to be done without proper consultation and that the arrangements had rather broken down, and we had to come in in a big way to get over that; partly to deal with the immediate problem that there was, but also to re-establish the feeling that the authorities were co-operating and had the thing in hand, and I believe that last year's International Monetary Fund arrangements made a big contribution to that as well.

COMMISSIONER GIBSON: Do you see any serious risk of lack of international liquidity?

LORD COBBOLD: Oh well, there could be in certain circumstances, but it had not bothered me so long as I was in the bank.

COMMISSIONER GIBSON: From what you say I gather that one of the key factors in this picture in your mind would be confidence in the dollar sterling in maintaining that degree of liquidity?

LORD COBBOLD: Yes, confidence in the dollar sterling rate.

COMMISSIONER GIBSON: You have answered the questions in your initial statement pretty thoroughly. I am just wondering if you care to say anything about the Canadian position from a foreign exchange point of view. We operate in somewhat different circumstances and, as you know, we are closely economically associated with the United States both in a trade way and in an investment way; we are subject to very large capital movements and we, as you know, have had a number of problems about what is the appropriate exchange rate policy, and I wonder if you would care to say something about that?

LORD COBBOLD: I really don't think I am competent to do so.

COMMISSIONER GIBSON: Do you see any reason why we should have a different kind of policy, for example, than the United Kingdom because of our particular position?

LORD COBBOLD: In many ways I think you must have to some extent a different kind of policy.

COMMISSIONER GIBSON: Well, I don't want to question you on this point if you --

LORD COBBOLD: I don't really feel I could make any useful contribution to that.

THE CHAIRMAN: We are now finished.

LORD COBBOLD: Thank you.

THE CHAIRMAN: I may say that we appreciate immensely your assistance. The discussion has been of very great interest from beginning to end, and I just wish to express our thanks and our great

COMMISSIONER GIBSON: You have answered the questions in your initial statement [illegible]

I am just wondering if you care to say anything about the Canadian position from a foreign exchange point of view. We operate in somewhat different circumstances and, as you know, we are closely economically associated with the United States both in a trade way and in an investment way; we are subject to very large capital movements and we, as you know, have had a number of problems about what is the appropriate exchange rate policy, and I wonder if you would care to say something about that.

LORD COBBOLD: I really don't think I am competent to do so.

COMMISSIONER GIBSON: Do you see any reason why we should have a different kind of policy, for example, than the United Kingdom because of our particular position?

LORD COBBOLD: In many ways I think you must have to some extent a different kind of policy.

COMMISSIONER GIBSON: Well, I don't want to question you on this point if you --

LORD COBBOLD: I don't really feel I could make any useful contribution to that.

THE CHAIRMAN: We are now finished.

LORD COBBOLD: Thank you.

THE CHAIRMAN: I may say that we appreciate immensely your assistance. The discussion has been of very great interest from beginning to end, and I just wish to express our thanks and our great

appreciation for your presence here with us.

LORD COBBOLD: Thank you very much. I thank you in my turn for your kindness and courtesy.

THE CHAIRMAN: We will adjourn now until 9:15 tomorrow morning.

---ADJOURNMENT

Royal Commission on Banking and Finance

DR. HOLTROP

Hearings held at OTTAWA

Vol. 35

Date. 11 SEP 1962

Official Reporters
F.J. Nethercut and R.J. Young
Toronto, Ont.

ROYAL COMMISSION ON BANKING

AND FINANCE

- - - - - -

Hearings held at Ottawa, Ontario, on Tuesday, September 11th, 1962.

- - - - - -

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W. A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

- - - - - -

Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

Ottawa, Ontario,
Tuesday, September 11, 1962.

On resuming at 9.20 A.M.

THE CHAIRMAN: Call the meeting to order. We have this morning a submission from Dr. Marius Holtrop of the Netherlands. We welcome you this morning, Dr. Holtrop, and we wish to express our appreciation to you for coming here and giving us what we anticipate will be very great assistance. We have all read your brief with great care and I may say we are all very much impressed with the presentation you have made in it, and I am sure there will be considerable questioning arising out of it. We are delighted to have you here and very grateful to you for coming.

DR. HOLTROP: Thank you, Mr. Chairman. I have no statement to make. I only want to assure you it is a pleasure for me to come to this Commission and help you in the work you are doing.

THE CHAIRMAN: I suggest, Dr. Holtrop, that, there being a number of people in the room who wish to hear you, you keep that in mind; it is sometimes difficult to make yourself heard in this room. I am sure they all want to hear everything you have to say. Do you wish to make a statement?

DR. HOLTROP: No, Mr. Chairman; I have no special statement to make.

As a matter of introduction, I want to stress that my memorandum, of course, is based on my own Dutch experience and on the general approach to the monetary problems, and that I have not specifically

On resuming at 9.20 A.M.

THE CHAIRMAN: Call the meeting to order. We have this morning a submission from Dr. Marius Holtrop of the Netherlands. We welcome you this morning, Dr. Holtrop, and we wish to express our appreciation to you for coming here and giving us what we anticipate will be very great assistance. We have all read your brief with great care and I may say we are all very much impressed with the presentation you have made in it, and I am sure there will be considerable questioning arising out of it. We are delighted to have you here and very grateful to you for coming.

DR. HOLTROP: Thank you, Mr. Chairman. I have no statement to make. I only want to assure you it is a pleasure for me to come to this Commission and help you in the work you are doing.

THE CHAIRMAN: I suggest, Dr. Holtrop, that, there being a number of people in the room who wish to hear you, you keep that in mind; it is sometimes difficult to make yourself heard in this room. I am sure they all want to hear everything you have to say. Do you wish to make a statement?

DR. HOLTROP: No, Mr. Chairman; I have no special statement to make.

As a matter of introduction, I want to stress [illegible]

thought of Canadian conditions because I thought it natural you would like to compare the situations in other countries with the Canadian situation. I have no specific knowledge, nor sufficient knowledge of your Canadian conditions to venture opinions about them, and I would only stress that nothing in my paper has any background or suggestion of giving opinions about the situation here. I know it is different, and it would take a lot of study to be able to venture opinions about the situation as we find it in this country.

COMMISSIONER BROWN: Dr. Holtrop, perhaps it would serve as an introduction if you would outline for us the organization and management of the Netherlands Central Bank.

DR. HOLTROP: I would be glad to, Mr. Chairman. The organization of the Netherlands Bank is perhaps only to be understood quite clearly when one takes into consideration that it is a very old institution which has evolved. The Netherlands Bank was created in 1814 as a general bank with the special right of note issue and with private shareholders.

It was nationalized just after the war. Shares were taken over by the government, but the nationalization has not brought very much change in its structure; practically none, I would say. The consequence is that it is still that kind of a limited liability company under Dutch law with some special rules which do not apply to other limited liability companies, because the shareholders do not have specific rights of great importance. They have no great rights, because previously, under the

[illegible] of Canadian [illegible] [illegible] [illegible] cou[illegible] specific knowledge, nor sufficient knowledge of your Canadian conditions to venture opinions about them, and I would only stress that nothing in my paper has any background or suggestion of giving opinions about the situation here. I know it is different, and it would take a lot of study to be able to venture opinions about the situation as we find it in this country.

COMMISSIONER BROWN: Dr. Holtrop, perhaps it would serve as an introduction if you would outline for us the organization and management of the Netherlands Central Bank.

DR. HOLTROP: I would be glad to, Mr. Chairman. The organization of the Netherlands Bank is perhaps only to be understood quite clearly when one takes into consideration that it is a very old institution which has evolved. The Netherlands Bank was created in 1814 as a general bank with the special right of note issue and with private shareholders.

It was nationalized just after the war. Shares were taken over by the government, but the nationalization has not brought very much change in its structure; practically none, I would say. The consequence is that it is still that kind of a limited liability company under Dutch law with some special rules which do not apply to other limited liability companies, because the shareholders do not have specific rights of great importance. They have

charter of the bank, it was thought right the shareholders should not influence the business of the bank too much. So, we find an institution where most of the executive powers are in the board of management, the managing directors, where there is a board of commissioners which, for internal purposes, controls the board of management, a board of commissioners which convenes only once a month, in which one member specially represents the government. He is the Royal commissioner and he is the one who reports also to the minister if he thinks it necessary about the goings on in the bank and discussions between the board of commissioners and the management.

Then, there was created in the Bank Act of 1947 a second body called the bank council. The bank council is a body which is advisory to the minister of finance in all matters pertaining to monetary policy. It can take the initiative itself, but usually it has to be consulted by the minister of finance in those cases where the law gives the minister of finance specific powers in relation to the bank's business. The bank council is a body which, as expressed by the Act, is the representation of the total community in the bank. It consists of 17 members who are appointed by the Crown and who are nominated by specific groups that are indicated by the law or by special Royal decree. These special groups who make these nominations are, for example, the employers associations to represent trade and industry and commerce; the trade unions to represent labour; agriculture is represented; transportation is represented; banking is represented; the stock exchange is represented; economic

harter of the bank, it was thought right the shareholders should not influence the business of the bank too much. So, we find an institution where most of the executive powers are in the board of management, the managing directors, where there is a board of commissioners which, for internal purposes, controls the board of management, a board of commissioners which convenes only once a month in which one member specially represents the government. He is the Royal commissioner and he is the one who reports also to the minister if he [illegible] about the goings on in the bank and discussions between the board of commissioners and the management.

Then, there was created in the Bank Act of 1947 a second body called the bank council. The bank council is a body which is advisory to the minister of finance in all matters pertaining to monetary policy. It can take the initiative itself, but usually it has to be consulted by the minister of finance in those cases where the law gives the minister of finance specific powers in relation to the bank's business. The bank council is a body which, as expressed by the Act, is the representation of the total community in the bank. It consists of 17 members who are appointed by the Crown and who are nominated by specific groups that are indicated by the law or by special Royal decree. These special groups who make these nominations are, for example, the employers associations to represent trade and industry and commerce; the trade unions to represent labour; agriculture is represented; transportation is represented; banking is represented; the stock exchange is represented; economic

science is represented. So, this is a broad body representing all sorts of aspects of the total life of the community and, as I say, acts in an advisory capacity. It convenes at least six times a year.

The president of the bank has to report about current economic conditions to this body, and on the basis of these reports, and bank policies, of course, there are general discussions about the policies of the bank and about the conditions, and this is a two-way affair. We think it is a very important thing. It has two ways of influencing: it is a body that gives the management of the bank the opportunity to consult people out of different shades of life, about how their thinking is in the sphere of bank policy or the sphere of economic development. Also the management of the bank conveys monetary thinking to that body, and that body is a high representation of the community: for example, I think I mentioned in my brief, the presidents of the three great trade unions in the country are in the body and it gives an opportunity to explain monetary policies also to those people. So, I think it is a very useful body for the exchange of information both ways.

The actual powers in the bank, that is, the powers of decision, are concentrated in the board of management which is appointed by the Crown on nominations made by the board of commissioners. The Crown can appoint the president outside the nomination if it thinks fit, after having sent back the nomination a few times.

The tendency is

that there is a strong influence in the appointment of the management of the bank to the body of the bank itself. It is kind of an influence of perpetuation and keeping it in the professional sphere. As far as I can judge, all appointments for the management of the bank have been of a completely non-political nature.

A very important thing in the relationship between bank and government is the right of the minister of finance to give directives to the bank management in case he considers it necessary to co-ordinate the monetary policies of the bank and the government, so that in case of a difference in monetary policies, then the minister of finance can give directives to the management. The management, though, has the right to appeal to the Crown. That means, in a constitutional monarchy as ours is, appeal really to the council of ministers. The council of ministers will have to decide, and there is for all normal circumstances the obligation of publication of the briefs exchanged and the differences of opinion that have come out in the official gazette. This right of giving directives has never been used yet but it is, of course, fundamental to the background of the relationship between the ministry of finance and the bank. So, I think it is a very satisfactory setup in so far as it is necessary, that in the end there should be one captain on a ship. When there is really deep differences of opinion about the execution of monetary policy between bank and government there must be a solution, and that solution can be forced by this right of directive. On the other hand, the right of directive cannot be taken

that there is a strong influence in the appointment of the management of the bank to the body of the bank itself. It is kind of an influence of perpetuation and keeping it in the professional sphere. As far as I can judge, all appointments for the management of the bank have been of a completely non-political nature.

A very important thing in the relationship between bank and government is the right of the minister of finance to give directives to the bank management in case he considers it necessary to co-ordinate the monetary policies of the bank and the government, so that in case of a difference in monetary policies, then the minister of finance can give directives to the management. The management, though, has the right to appeal to the Crown. That means, in a constitutional monarchy as ours is, appeal really to the council of ministers. The council of ministers will have to decide, and there is for all normal circumstances the obligation of publication of the briefs exchanged and the differences of opinion that have come out in the official gazette. This right of giving directives has never been used yet but it is, of course, fundamental to the background of the relationship between the ministry of finance and the bank. So, I think it is a very satisfactory setup in so far as it is necessary, that in the end there should be one captain on a ship. When there is really deep differences of opinion about the execution of monetary policy between bank and government there must be a solution, and that solution can be forced by this right of directive. On the other hand, the right of directive cannot be taken

lightly, so that there is a kind of equity created that way in consultation between the bank and the ministry of finance about policies, if that is necessary.

I should say that in practice we feel that the bank's business is to be considered mainly the bank's responsibility under normal circumstances, while, of course, the business of the ministry of finance is completely the responsibility of the ministry of finance, and in practical life we have not found great difficulties there in the period of my office, which is since 1946.

I think those are the most important features of the setup of the bank. If I have forgotten any point which you think is of interest, I might invite a question about it. This is a general outline of what is of importance.

COMMISSIONER BROWN: You mentioned the board of commissioners that meets once a month. That is more frequently than the bank council?

DR. HOLTROP: Yes.

COMMISSIONER BROWN: How big a body is this, and who appoints them? What power have they got?

DR. HOLTROP: The board of commissioners is a board of 12 members. The board of commissioners can really only be understood from the point of view of Dutch company law, and they were originally the only controlling body of the bank management. The board of commissioners in Dutch law takes somewhat the place of the board of directors under British law. Its powers are slightly less because they are not generally

lightly, so that there is a kind of equity created that way in consultation between the bank and the ministry of finance about policies, if that is necessary.

I should say that in practice we feel that [illegible] the bank's responsibility under normal circumstances, while, of course, the business of the ministry of finance is completely the responsibility of the ministry of finance, and in practical life we have not found great difficulties there in the period of my office, which is since 1946.

I think those are the most important features of the setup of the bank. If I have forgotten any point which you think is of interest, I might invite a question about it. This is a general outline of what is of importance.

COMMISSIONER BROWN: You mentioned the board of commissioners that meets once a month. That is more frequently than the bank council?

DR. HOLTROP: Yes.

COMMISSIONER BROWN: How big a body is this, and who appoints them? What power have they got?

DR. HOLTROP: The board of commissioners is a board of 12 members. The board of commissioners can really only be understood from the point of view of Dutch company law, and they were originally the only controlling body of the bank management. The board of commissioners in Dutch law takes somewhat the place of the board of directors under British law. Its powers [illegible]

responsible for the management. They are controlling the management for the benefit of the shareholders. They may by statute have certain powers, but then it has to be explicitly given by statute. Certain decisions of the management may have to be referred to the board of commissioners, but that is not necessarily so. They are the body in company law, therefore, that controls the directors and makes the nominations also for new directors. In the bank they have been given a single bigger power because they are the ones who approve the balance sheet of the bank which generally, under Dutch company law, is a power of the meeting of shareholders, but, as I said, shareholders of the bank never had the full powers of shareholders as they have in other limited liability companies, and this power was given to the board of commissioners, so that they approve the balance sheet.

The purpose of the present banking act has been to make a certain difference between these two bodies, inasmuch as the bank council should be more the body that occupies itself specifically with bank policies, with monetary policy, while the board of commissioners is the body that is concerned with the organization and with the finances of the bank, with the internal organization, and all sorts of questions that come up there: so, it is questions of household, of profits and losses, questions of management and questions of salaries, and all that kind of thing which comes into the board of commissioners.

COMMISSIONER BROWN: How are they appointed?

DR. HOLTROP: They are appointed by shareholders,

[illegible]e for the management. They are controlling the management for the benefit of the shareholders. They may by statute have certain powers, but then it has to be explicitly given by statute. Certain decisions of the management may have to be referred to the board of commissioners, but that is not necessarily so. They are the body in company law, therefore, that controls the directors and makes the nominations also for new directors. In the bank they have been given a single bigger power because they are the ones who approve the balance sheet of the bank which generally, under Dutch company law, is a power of the meeting of shareholders, but, as I said, shareholders of the bank never had the full powers of shareholders as they have in other limited liability companies, and this power was given to the board of commissioners, so that they approve the balance [illegible]

The purpose of the present banking act has been to make a certain difference between these two bodies, inasmuch as the bank council should be more the body [illegible] with monetary policy, while the board of commissioners is the body that is concerned with the organization and with the finances of the bank, with the internal organization and all sorts of questions that come up there. So it is questions of household, of figures and losses, question of management and questions of salaries, and all that [illegible]

COMMISSIONER BROWN: How are they appointed?

DR. HOLTROP: They are appointed by shareholder

which practically means now, of course, the minister of finance because he represents the state as the only shareholder; but they are appointed on a nomination which is made by the joint meeting of the bank council and the board of commissioners itself. So, again, there is the tendency of giving the bank itself a strong influence in perpetuating the bodies that control the bank. The minister of finance, as representative shareholder, cannot go outside that nomination.

COMMISSIONER BROWN: Is there an interlocking or an overlapping between the two bodies?

DR. HOLTROP: There are four members of the board of commissioners who are also members of the bank council. That is the link between the two.

COMMISSIONER BROWN: But the actual responsibility for operating, for changing the bank rate ...?

DR. HOLTROP: Is with the board of management only.

COMMISSIONER BROWN: And this consists of the president ...?

DR. HOLTROP: The president with four to six managing directors. We presently have four, so that we are a body of five people, which has a joint responsibility. This is, again, like the general position in Dutch company law: Dutch limited liability companies mostly have a board of managing directors that may be two or four or five who have a joint responsibility. Each of them bind the company legally and they take their decisions jointly, and the position of the president is that he has a deciding vote in the case of a tying vote. But, as a

matter of principle the president can be out-voted in the board of directors. It does not happen very much, but that is the legal position.

COMMISSIONER BROWN: Well, this managing board must meet continually?

DR. HOLTROP: It meets continually; we meet every day, yes. This managing board is,of course, comparable with what you know as the executive directors of the Bank of England -- the ones who are permanently there.

COMMISSIONER BROWN: They come up through the bank service?

DR. HOLTROP: They may or may not. There are always several managing directors who have come up through the bank service, but there are also some who may have come from the outside. I would say it is usual that the president comes from the outside. Among my present colleagues -- and we are five -- there are three who really have had a long career with the bank before becoming managing directors; one left the bank and later came back as a managing director, and one of my colleagues was a banker and came into the bank from private banking. I, myself, came from industry.

COMMISSIONER BROWN: What are the terms of appointment?

DR. HOLTROP: We are all appointed for a period of seven years, and we cannot be discharged unless we are impeached for extremely special reasons. So this is a fixed appointment for seven years, and it is usual, one must say, that these appointments are continued.

[illegible]

COMMISSIONER BROWN: Well, this managing [illegible]

DR. HOLTROP: It meets continually; we meet every day, yes. This managing board is, of course, comparable with what you know as the executive directors of the Bank of England -- the ones who are permanently [illegible]

COMMISSIONER BROWN: They come up through the bank service?

DR. HOLTROP: They may or may not. There are always several managing directors who have come up through the bank service, but there are also some who may have come from the outside. I would say it is usual that the president comes from the outside. Among my present colleagues -- and we are five -- there are three who really have had a long career with the bank before becoming managing directors; one left the bank and later came back as a managing director, and one of my colleagues was a banker and came into the bank from private banking. I, myself, came from industry.

COMMISSIONER BROWN: What are the terms of [illegible]

DR. HOLTROP: [illegible] say, that these appointments are continued.

So, once a director, the usual thing is that a director continues until the pensionable age.

COMMISSIONER BROWN: What are the terms of appointment to the bank council and board of commissioners?

DR. HOLTROP: I think they are all four-year terms. The board of commissioners has a four-year term -- yes, both of them have. They fall due according to a certain schedule, and they come up for re-appointment after that period.

COMMISSIONER BROWN: In practice do you get an opportunity or does the management board get an opportunity to suggest these nominations?

DR. HOLTROP: We might be consulted, yes; because the Board of Commissioners as a matter of fact mostly has meetings together with the managing board, so we have a joint meeting of the managing board and the Board of Commissioners. Of course, these nominations are formally not our business; we may venture opinions, but we never try to influence these nominations, we leave that to the members who are formally concerned with making the nominations.

COMMISSIONER BROWN: Thank you very much.

COMMISSIONER GIBSON: To change the subject a little, I would like to ask you to elaborate a bit more on the question of the objectives of monetary policy. You have put a little different emphasis on this than some other bankers and you stated that the primary objective was to maintain the internal and external value of the monetary unit under conditions of reasonable employment. You said that the maintenance of full employment, while obviously a major objective of a national economic

policy must necessarily be a secondary objective of monetary policy and you don't in the memorandum mention it -- I don't think you are referring to growth as an objective, although perhaps that is included in full employment.

I wondered if you could say a little more about the conflicts between the objectives, the two-fold objective which you mentioned and the primary one, that is, the maintenance of the internal and external value of the currency, and perhaps if one were to do that it would bring out a little more some of the possible conflicts in connection with the secondary objectives. In other words, as you said, there are times when the two-fold objectives of maintaining the internal-external value of the currency are in conflict, and these are not infrequent occasions, and I am wondering if you would give us a few examples of the times when they are in conflict and what you would think was an appropriate policy under these conditions -- perhaps rather extreme examples -- is this a reasonable question to put to you?

DR. HOLTROP: I think the question by itself is reasonable enough, although it is not so easy to answer in the abstract because it is difficult then to circumscribe all the circumstances that might occur in certain moments, but I would like to elaborate on that because I know I have given a little different stress than is sometimes given, and the remarkable thing is -- in a way it is remarkable -- that I do

policy must necessarily be a secondary objective of monetary policy and you don't in the memorandum mention it -- I don't think you are referring to growth as an objective, although perhaps that is included in full employment.

I wondered if you could say a little more about the conflicts between the objectives, the two-fold objective which you mentioned and the primary one, that is, the maintenance of the internal and external value of the currency, and perhaps if one were to do that it would bring out a little more some of the possible conflicts in connection with the secondary objectives. In other words, as you said, there are times when the two-fold objectives of maintaining the internal-external value of the currency are in conflict, and these are not infrequent occasions, and I am wondering if you would give us a few examples of the times when they are in conflict and what you would think was an appropriate policy under these conditions -- perhaps rather extreme examples -- is this a reasonable question to put to you?

DR. HOLTROP: I think the question by itself is reasonable enough, although it is not so easy to answer in the abstract because it is difficult then to circumscribe all the circumstances that might occur in certain moments, but I would like to elaborate on that because I know I have given a little different stress than is sometimes given, and the remarkable thing is -- in a way it is remarkable -- that I do

give this stress not only out of full conviction myself, but that it is also the stress that is given in the Bank Act, the Netherlands Bank Act. Article 9 of the Netherlands Bank Act states what the task of the Netherlands Bank is, and in that description of the task of the Netherlands bank it says that the object and the policy of the bank should be to maintian the internal and the external value of the monetary unit -- no, it says to regulate. The Bank Act says that it is the task of the Netherlands bank to regulate the value of the monetary unit in such a way that it is most conducive to the interests of the country.

When you then ask what is meant and what can be meant by the value of the monetary unit you immediately come to that difference between the internal and the external value, and you have to realize that our Bank Act does not go into this; it only says it should try to stabilize as much as possible that value.

Now, theoretically, when we ask ourselves what we mean by the value of money, we immediately come to the problem of the internal and external value, and we have to distinguish between the value of money in the sense of purchasing power and the value of money in the sense of the exchange rate; the relationship between one monetary unit and another monetary unit. Since we live in a world in which, and have lived for a long time in a world in which we need stable rates of exchange, and we have

[illegible]

in the Bank Act, the Netherlands Bank Act. Article 9 of the Netherlands Bank Act states what the task [illegible] of the task of the Netherlands bank it says that the object and the policy of the bank should be to maintain the internal and the external value of the monetary unit -- no, it says to regulate. The Bank Act says that it is the task of the Netherlands bank to regulate the value of the monetary unit in such a way that it is most conducive to the interests [illegible]

When you then ask what is meant and what can be meant by the value of the monetary unit you immediately come to that difference between the internal and the external value, and you have to realize that our Bank Act does not go into this; it only says it should try to stabilize as much as possible that value.

Now, theoretically, when we ask ourselves what we mean by the value of money, we immediately come to the problem of the internal and external value, and we have to distinguish between the value of money in the sense of purchasing power and the value of money in the sense of the exchange rate; the relationship between one monetary unit and another monetary unit. Since we live in a world in which, and have lived for a long time in a world in which we need stable rates of exchange, and we have

proceeded to maintain these stable rates of exchange, it is obvious to us that one of the primary tasks of the central bank is, indeed, to perpetuate the conditions which are conducive tothe maintenance of the external value of the monetary unit; that is, to maintain the exchange rates or the parity of the monetary unit.

On the other hand, we agree that it is the purpose of monetary policy to maintain the value of money; that is, the purchasing power of money. That brings up, indeed, a question of definition, what you mean by the purchasing power; what purchasing power, is it the cost of living, is it the wholesale prices; what kind of index do you mean? Now, on the other hand this brings in all sorts of questions of detail. We have a general notion of what we mean by maintaining the purchasing power of money.

Now, I think that these two, under certain circumstances may clash, because maintaining the purchasing power of value may clash with maintaining the exchange of stability in cases where in the outside world there are no conditions of equilibrium but either a deflation as we have known them in the thirties, or inflationary conditions as we have known them in the forties, and then the purposes of maintaining the internal and external value may come into contradiction with one another, as I have explained here, and also in my brief, and in a certain moment the

needed to maintain these stable rates of exchange. It is obvious to us that one of the primary tasks of the central bank is, indeed, to perpetuate the conditions which are conducive to the maintenance of the external value of the monetary unit; that is, to maintain the exchange rates or the parity of the monetary unit.

On the other hand, we agree that it is the purpose of monetary policy to maintain the value of money; that is, the purchasing power of money. That brings up, indeed, a question of definition, what you mean by the purchasing power; what purchasing power, is it the cost of living, is it the wholesale prices; what kind of index do you mean? Now, on the other hand this brings in all sorts of questions of detail. We have a general notion of what we mean by maintaining the purchasing power of money.

Now, I think that these two, under certain circumstances may clash, because maintaining the purchasing power of value may clash with maintaining the exchange of stability in cases where in the outside world there are no conditions of equilibrium but either a deflation as we have known them in the thirties, or inflationary conditions as we have known them in the forties, and then the purposes of maintaining the internal and external value may come into contradiction with one another, as I have explained here, and in a certain moment the

monetary authorities may have to decide between the one and the other.

Now you may remember that in my memo I have taken the position that by monetary policy generally I mean more than only central bank policy, and I think that it is a mistake, really -- I know that it is widely being done -- but there is a kind of tendency to use the phrase "monetary policy" for "central bank policy" only, and I think that it leads to unclear thinking if you do this and it is a danger not to recognize that monetary policy is the whole field of monetary management and that central bank policy is only part of it.

I think that central bank policy, while it has to choose between the two -- I mean, maintaining a certain parity and maintaining the internal purchasing power -- must give some preference to the external value because the instruments of policy which the central bank controls are instruments of policy which are more conducive, more ready to be used for the purpose of maintaining the external purchasing power than the internal purchasing power. But in certain moments the country must come to the point where it has to clearly choose between the two, and our courntry has been over this and your country has been also, and these moments may come, where, indeed, a choice has to be made between internal and external stability and either a decision for devaluation or re-

valuatior, that is, a change in the external parity, may have to be taken.

COMMISSIONER GIBSON: You made such a decision quite recently, didn't you?

DR. HOLTROP: We made such a decision quite recently and that is, of course, the type of decision in which the opinion of the government, prevails above the opinion of the central bank. It is too important a decision to be left to the central bank. It is a government decision but, indeed, that type of clash may come, and accordingly a decision has to be taken.

Now, your question was about the relationship between this purpose and the purpose of full employment or the purpose of growth.

My approach to monetary problems is, after all, that monetary policy as such is an instrument which has the purpose of creating the most favourable monetary conditions, and by "monetary conditions" I specifically think, indeed, of the disturbances that can possibly be caused in the economy by the use of the instrument of money. The fundamental thing about the use of money is, indeed, that by the use of money we have created a split between the act of supply and the act of demand; it is possible to supply without demanding because you can hoard the money and you create a disturbance because that way you create an over-supply to demand, and the reverse is also possible by the use of money; if you have stored up money or you can create new

money you can demand, you can execute a demand on the market without supplying anything, and that is fundamentally what we mean by deflationary and inflationary influences. That is the monetary approach to the problems, and in my opinion the fundamental purpose of monetary policy should be and ought to be to reduce these types of disturbances to the minimum. You can never achieve 100 per cent there, that is impossible because you haven't the possibility of observation, where an excess demand occurs. Yet the purpose of monetary policy should be to create conditions of stable demand against the possibilities of supply, and to create that equilibrium of demand and supply in conditions of what I have called "reasonably full employment". I will just mention in this connection that it is only a few years ago that in Holland we considered 3 per cent unemployment as the point where disturbance about the employment situation was ready to come up, but we have now gone through several years of one per cent unemployment and I am conscious of the fact that 3 per cent unemployment at the present moment would be considered a disastrous condition, while in the late fifties we still considered 3 per cent unemployment fairly satisfactory, and as giving no reason for specific policies to

combat unemployment if it wouldn't be larger than 3 per cent.

Now, to come back to monetary policy. It is my opinion that monetary policy should only be used to combat monetary disturbances, and if unemployment is caused by monetary disturbances then it is, indeed, the task of monetary policy to combat that condition. But it is also conceivable that unemployment is the consequence of quite other causes, such as wage policies, price policies, international shift of demand, and there I only want to stress the point that I think it would be completely wrong to believe that you could use monetary policy to correct conditions that are caused by other than monetary disturbances. When the conditions that have created unemployment have no monetary character, I don't believe that monetary policy can be used to combat those conditions, and if you did you are certainly going to come into conflict with other purposes of monetary policy, and therefore I have stressed this point and I have said that the purpose of monetary policy is to create conditions of stable demand, conditions of stability of the

combat unemployment if it wouldn't be larger than 3 per cent.

Now, to come back to monetary policy. It is my opinion that monetary policy should only be used to combat monetary disturbances, and if unemployment is caused by monetary disturbances then it is, indeed, the task of monetary policy to combat that condition. But it is also conceivable that unemployment is the consequence of quite other causes, such as wage policies, price policies, international shift of demand, and there I only want to stress the point that I think it would be completely wrong to believe that you could use [illegible] caused by other than monetary disturbances. When the conditions that have created unemployment have no monetary character, I don't believe that monetary policy can be used to combat those conditions, and if you did you are certainly going to come into conflict with other purposes of monetary policy, and therefore I have stressed this point and I have said that the purpose of monetary policy is to create conditions of stable demand, conditions of stability of the

internal and external value of the monetary unit under conditions of reasonably full employment.

If you haven't got those conditions of satisfactory employment it is a question of investigation into the causes of that condition that could give you a solution to the instrument of policy that could be used to create that condition, and it is not a natural conclusion that you could use monetary policy to create that condition. One might take an extreme example to make that clear. I have been told that you had a uranium boom in this country at a certain moment and suddenly the demand for uranium went down. That no doubt must have created conditions of unemployment in those centres which produced uranium. You couldn't combat that with monetary policy because you couldn't create a demand for uranium that way.

There I have given an example of a clear and extreme case where it is easily recognizable that certain disturbances have caused the condition, and that the instruments of policy to be used in correcting those disturbances should be sought in the direction of the cause of the disturbances. It is for this reason that I have stressed these differences.

Of course, here I may mention that I am labouring under some difficulty of language. When I use the word "secondary" I do not know for sure whether that conveys to you anything of a derogatory connotation; if so then let me say that I do not mean that. When I describe something as primary I mean it is the thing that is really closely connected with a subject, and that secondary things are the ones that come in only as a second instance but which to a certain extent may play a role but which in the end cannot play the final role.

THE CHAIRMAN: I think you mean "less closely connected with monetary policy".

DR. HOLTROP: Yes, that is right -- less closely connected.

COMMISSIONER GIBSON: Conceptually, Dr. Holtrop, I understand your point very clearly, but as a practical matter are there not many cases where it is very hard to decide whether there is monetary dis-

There I have given an example of a clear and extreme case where it is easily recognizable that certain disturbances have caused the condition, and that the instruments of policy to be used in correcting these disturbances should be sought in the direction of the cause of the disturbances. It is for this reason that I have stressed these differences.

Of course, here I may mention that I am labouring under some difficulty of language. When I use the word "secondary" I do not know for sure whether that conveys to you anything of a derogatory connotation; if so then let me say that I do not mean that. When I describe something as primary I mean it is the thing that is really closely connected with a subject, and that secondary things are the ones that come in only as a second instance but which to a certain extent may play a role but which in the end cannot play the final role.

THE CHAIRMAN: I think you mean "less closely connected with monetary policy".

DR. HOLTROP: Yes, that is right -- less closely connected.

COMMISSIONER [illegible]: Consequently, Dr. Holtrop, I understand your point very clearly, but as a practical matter are there not many cases where it is very hard to decide whether there is monetary dis-

equilibrium or not, and do you not, in fact, have to look on the side of various economic measures as well as monetary balance in deciding just when to move in?

DR. HOLTROP: Oh, yes, we definitely do. I have mentioned the employment situation as one of the indicators which are of importance in judging a monetary policy.

In my own country we have had different experiences. I remember that we had a lot of unemployment after the Korea boom in the period from 1951 to 1953. At that time unemployment figures were rather high, but then I know that the government made a study of that type of unemployment, and the labour bureaux did also, and we were clever enough to distinguish between cyclical unemployment and structural unemployment and other sorts of unemployment. That is the approach we took. We applied the best kind of thinking we could to a certain problem, and we gave it the best kind of analysis without it being all arithmetic, and we definitely came to the conclusion that it can be recognized that there are parts of the country in which unemployment was occasionally due to the fact of improvement in techniques. For example, improvement in agricultural techniques made agricultural labour redundant, and there were pockets of rather high unemployment for that reason. In those cases the government very rightly considered that it could not do anything about that by a general monetary policy.

In those areas the government took decisions as to specific policies directed to those regions which facilitated the establishment of new industries there to

equilibrium or not, and do you not, in fact, have to look on the side of various economic measures as well as monetary balance in deciding just when to move in?

DR. HOLTROP: Oh, yes, we definitely do. I have mentioned the employment situation as one of the indicators which are of importance in judging a monetary policy.

In my own country we have had different experiences. I remember that we had a lot of unemployment after the Korea boom in the period from 1951 to 1953. At that time unemployment figures were rather high but then I know that the government made a study of that type of unemployment, and the labour bureaux did also, and we were clever enough to distinguish between cyclical unemployment and structural unemployment and other sorts of unemployment. That is the approach we took. We applied the best kind of thinking we could to a certain problem, and we gave it the best kind of analysis without it being all arithmetic, and we definitely came to the conclusion that it can be recognized that there are parts of the country in which unemployment was occasionally due to the fact of improvement in techniques. For example, improvement in agricultural techniques made agricultural labour redundant, and there were pockets of rather high unemployment for that reason. In those cases the government very rightly considered that it could not do anything about that by a general monetary policy.

In those areas the government took decisions as to specific policies directed to those regions which facilitated the establishment of new industries there to

combat the local unemployment which was created by those specific conditions.

On the other hand, of course, we, at the same time, had a general policy of lowering our discount rate, of making credit conditions easier and of allowing the government to have a deficitary budget. Those were means of purely monetary action which were meant to improve the general conditions, but without forgetting that there were specific reasons for specific parts of the problem, and not relying on the idea that by monetary policy alone you could cope with the problem as a whole.

I think that is important. It is important, also, to make that distinction when talking about monetary policy because I find that in other countries there has been a tendency to accept monetary policy as a kind of a cure-all, whereas monetary policy in the sense of central banking policy can only be used as a means of just improving the general conditions.

When we talk about growth it is quite clear that the determinants of growth cannot be found in general demand only. The determinants of growth can be found in a lot of other things such as education, and also in the volume of savings and the amount of investment. These are all things that cannot be controlled by monetary policy.

COMMISSIONER GIBSON: Going back to your example, in 1952 you had an under-employment problem?

DR. HOLTROP: Yes.

COMMISSIONER GIBSON: Did you ease monetary conditions more then than you would have in terms of the purely monetary measures because it was an under-employment problem, or did you do just what you felt was right in the monetary circumstances?

DR. HOLTROP: I would not pretend -- certainly not at that time -- that we would be able to so closely assess quantitatively what we could do in the one field and in the other, but certainly at that moment we eased monetary conditions. At that time it was also clear that the expansion of banking credit was almost negligible, as you usually find in a period of recession. You find that easing monetary conditions does not lead to a strong upsurge in expenditures. You have to ride out the period of recession in a way, and create the conditions in which it is easy for business to pick up as soon as it feels like picking up.

COMMISSIONER GIBSON: Are you concerned about creating too much so that later there may be difficulty?

DR. HOLTROP: No, we have not been concerned with that because, actually, there was not that condition. You might be concerned with that from the point of view of budgetary policy. My general contention would be that central bank policy, which is monetary policy, as applied to the private sector of the economy, has not the power to exaggerate money creation in times of recession because the economy just will not take it. Monetary policy in that sense is most active in a period of boom because there the restrictive forces of monetary policy by the central bank can really be of importance.

COMMISSIONER GIBSON: Did you ease monetary conditions more than you would have in terms of the purely monetary measures because it was an under-employment problem, or did you do just what you felt was right in the monetary circumstances?

DR. HOLTROP: I would not pretend -- certainly not at that time -- that we would be able to so closely assess quantitatively what we could do in the one field and in the other, but certainly at that moment we eased monetary conditions. At that time it was also clear that the expansion of banking credit was almost negligible, as you usually find in a period of recession. You find that easing monetary conditions does not lead to a strong upsurge in expenditures. You have to ride out the period of recession in a way, and create the conditions in which it is easy for business to pick up as soon as it feels like picking up.

COMMISSIONER [illegible]: Are you [illegible] creating too much so that later there may be difficulty?

DR. HOLTROP: No, we have not been concerned with that because, actually, there was not that condition You might be concerned with that from the point of view of budgetary policy. My general contention would be that central bank policy, which is monetary policy, as applied to the private sector of the economy has not the power to exaggerate money creation in times of recession because the economy just will not take it. Monetary policy in that sense is most active in a period of boom because there the restrictive forces of monetary policy by the central bank can really be of importance.

COMMISSIONER GIBSON: But you can make the banks so liquid that later on there will have to be a big expansion; is not that right?

DR. HOLTROP: Theoretically, no -- not under our Dutch conditions, at any rate. It would always be within your control to take away that liquidity later, I think. In my experience I have never coped with the problem of central bank policy being too expansionary in a period of recession because you really have not got the opportunity.

COMMISSIONER GIBSON: Why is that? I would have thought that under North American conditions this was eminently possible, that a state of liquidity might be created that might embarrass you later on. You say this is not feasible in Holland on the part of the central bank. This is one of the things that worries our people at times.

DR. HOLTROP: Yes. There is again that difference of conditions between different countries. I would still maintain that in Holland you would not try to do it because it would not help. Making the banks more liquid in that kind of period would only be possible by buying short-term paper out of the portfolio of the banks for the portfolio of the central bank. This would add to the liquidity of the banking system without having much influence, in my opinion, under our conditions on their active policies.

I know that in the United States that would be somewhat different because the banking system in the United States would be induced to go into more long-term

COMMISSIONER GIBSON: But you can make the banks so liquid that later on there will have to be a big expansion; is not that right?

[illegible] Theoretically, no -- not under our Dutch conditions, at any rate. It would always be within your control to take away that liquidity later, I think. In my experience I have never coped with the problem of central bank policy being too expansionary in a period of recession because you really have not got the opportunity.

COMMISSIONER GIBSON: Why is that? I would have [illegible] eminently possible, that a state of liquidity might be created that might embarrass you later on. You say this is not feasible in Holland on the part of the central bank. This is one of the things that worries our people at times.

DR. HOLTROP: Yes. There is again that difference of conditions between different countries. I would still maintain that in Holland you would not try to do it because it would not help. Making the banks more liquid in that kind of period would only be possible by buying short-term paper out of the portfolio of the banks for the portfolio of the central bank. This would add to the liquidity of the banking system without having much influence, in my opinion, under our conditions on their active policies.

I know that in the United States that would be somewhat different because the banking system in the United States would be induced to go into more long-te

financing -- long-term portfolio investment -- which is not the habit of our banking system. Our banking system, for practical purposes, does not go into long-term portfolio investment, so you could not, under our Dutch conditions, influence very much the capital market conditions by your monetary policy in a period of recession-- at least, not to a big extent. I admit that under the conditions in the United States you could, and that there the danger might arise of creating too much liquidity which you could not control in a later period when suddenly the private sector would feel like spending.

COMMISSIONER GIBSON: The liquidity created by your government is a much smaller problem than the problem we have here?

DR. HOLTROP: It has become a much smaller problem. It was a very big problem just after the war. We have reduced very much our short-term debts since the war days, and we actually had until, I would say, about 1952 a condition of over-liquidity in the country. It was a kind of a permanent condition of over-liquidity which also came out in very low long-term interest rates. We had a period when our long-term interest rates were in the neighbourhood of 3 per cent. That was a natural condition. It was not purposely created. It was the result of an over-supply of liquidity from the war period of inflation which was not completely mopped up by the after-war measures. I would say that that gradually disappeared from about the early 50's.

COMMISSIONER GIBSON: How is it, sir, that the

financing -- long-term portfolio investment -- which [illegible] system, for practical purposes, does not go into long-term portfolio investment, so you could not, under our [illegible] conditions by your monetary policy in a period of recession -- at least, not to a big extent. I admit [illegible] and that there the danger might arise of creating too much liquidity which you could not control in a later period when suddenly the private sector would feel like spending.

COMMISSIONER GIBSON: The liquidity created by your government is a much smaller problem than the problem we have here?

DR. HOLTROP: It has become a much smaller problem. It was a very big problem just after the war. We have reduced very much our short-term debts since the war days, and we actually had until, I would say, about 1952 a condition of over-liquidity in the country. It was a kind of a permanent condition of over-liquidity which also came out in very low long-term interest rates. We had a period when our long-term interest rates were in the neighbourhood of 3 per cent. That was a natural condition. It was not purposely created. It was the result of an over-supply of liquidity from the war period of inflation which was not completely mopped up by the after-war measures. I would say that that gradually disappeared from about the early 50 s.

COMMISSIONER GIBSON: How is it, sir, that the

record of your country seems to be quite a little different from the records of a number of your partners in the European common market, and from those of the United States, Canada and Great Britain? You have got your national debt down more. You put much more emphasis -- I am expressing a view -- on the value of your currency, particularly its external value. You do not use open market operations to any major degree as an instrument of monetary policy and that is largely because, I take it, you do not have a large short-term debt. How do you explain this more prudent record as compared with the rest of the world? At the same time you have achieved a very high level of employment throughout the whole of the post-war period.

DR. HOLTROP: I think, in the first instance, that the European countries in the 40's at certain times made their mistakes in internal policy, and they have concluded that these mistakes lead to great difficulties and also to external deficits.

If you go back into the history of these European countries you will find that one after the other has been in balance of payments difficulties, and so has Germany. Germany was quite a problem in the late 40's, and we had to study the German case. I remember Per Jacobsen going to Germany for the B.I.S. to study the background of the German deficit.

We have come to the conclusion that inflationary policies by government lead to balance of payments deficits in the end, and since we could not cope with balance of payments deficits we rightly came to the

[illegible]

different from the records of a number of your partners in the European common market, and from those of the United States, Canada and Great Britain? You have got your national debt down more. You put much more emphasis -- I am expressing a view -- on the value of your currency, particularly its external value. You do not use open market operations to any major degree as an instrument of monetary policy and that is largely because, I take it, you do not have a large short-term debt. How do you explain this more prudent record as compared with the rest of the world? At the same time you have achieved a very high level of employment throughout the whole of the post-war period.

DR. HOLTROP: I think, in the first instance, that the European countries in the 40's at certain times made their mistakes in internal policy, and they have concluded that these mistakes lead to great difficulties and also to external deficits.

If you go back into the history of these European countries you will find that one after the other has been in balance of payments difficulties, and so has Germany. Germany was quite a problem in the late 40's, and we had to study the German case. I remember Per Jacobsen going to Germany for the B.I.S. to study the background of the German deficit.

We have come to the conclusion that inflationary policies by government lead to balance of payments deficits in the end, and since we could not cope with [illegible] deficits we rightly, came to the

conclusion that the monetary policies of the government were a very important part of the general monetary conditions.

COMMISSIONER GIBSON: So your great dependence on external trade helps you to reach these conclusions?

DR. HOLTROP: In my opinion that is definitely so. I am always conscious of the fact that we, as a small country with our high percentage of external trade have a problem in respect of balance of payments, and that there is a great reaction between balance of payments and monetary conditions.

Also, we have found it easier to explain monetary policies to the people. We have not found that very difficult. We have gone through several crises. There was one in 1951 at the time of the Korea boom which was caused by our internal boom which was based partly on old liquidity. There you have that example of existing liquidity that had never been completely mopped up and which could not be controlled because, after all, you cannot prevent people from using their own liquidity. At that time we had a strong boom which led to a bad balance of payments deficit. But, at that moment, we did not find it difficult to explain to our people, including the trade unions, and all those who partook in the general consultations about the general economic conditions, that we were actually in a condition of over-expenditure and that we simply spent more than we earned and that we could not continue to do so. They understood that the only way to improve upon that condition was to cut down on our total

were a very important part of the general monetary conditions.

COMMISSIONER GIBSON: So your great dependence on external trade helps you to reach these conclusions?

DR. HOLTROP: In my opinion that is definitely so. I am always conscious of the fact that we, as a small country with our high percentage of external trade have a problem in respect of balance of payments, and that there is a great reaction between balance of payments and monetary conditions.

Also, we have found it easier to explain monetary policies to the people. We have not found that very difficult. We have gone through several crises. There was one in 1951 at the time of the Korea boom which was caused by our internal boom which was based partly on old liquidity. There you have that example of existing liquidity that had never been completely mopped up and which could not be controlled because, after all, you cannot prevent people from using their own liquidity. At that time we had a strong boom which led to a bad balance of payments deficit. But, at that moment, we did not find it difficult to explain to our people, including the trade unions, and all those who partook in the general consultations about the general economic conditions, that we were actually in a condition of over-expenditure and that we simply spent more than we earned and that we could not continue to do so. They understood that the only way to improve

expenditure.

That was the period in 1951 when we agreed which the trade unions -- and this was quite exceptional -- that real wages should be reduced. It was in an indirect way, but as a consequence of the Korea boom the cost of living went up, and we agreed at that time that it was unavoidable and that we must let the cost of living go up by 10 per cent and allow wages to go up by only 5 per cent which compensated in part for the increase in the cost of living. We did that in order to get the total economy into equilibrium again.

COMMISSIONER GIBSON: That is why you did not have much unemployment?

DR. HOLTROP: At that time during the boom, of course, we had no great unemployment.

COMMISSIONER GIBSON: I mean after the boom of 1952.

DR. HOLTROP: The recession of 1952 led to over 3 per cent unemployment -- yes, definitely. Once you are out of equilibrium the process of getting back into equilibrium again is generally a painful process in which you can hardly avoid going past the equilibrium point over to the other side. It is a wave movement. Indeed, you might say that the fighting of the over-expenditure of the Korea boom has been one of the causes of a kind of recession after that in 1952-1953. We, therefore, had a period of too high unemployment, and then there were periods in which we started to introduce again an expansionary policy. That was in a period when we had a surplus after the big deficits we had after the

[illegible]

That was the period in 1951 when we agreed which the trade unions -- and this was quite exceptional [illegible] way, but as a consequence of the Korea boom the cost of living went up, and we agreed at that time that it was unavoidable and that we must let the cost of living go up by 10 per cent and allow wages to go up by only 5 per cent which compensated in part for the increase in the cost of living. We did that in order to get the total economy into equilibrium again.

COMMISSIONER GIBSON: That is why you did not have much unemployment?

DR. HOLTROP: At that time during the boom, of course, we had no great unemployment.

COMMISSIONER GIBSON: I mean after the boom of 1952.

DR. HOLTROP: The recession of 1952 led to over 3 per cent unemployment -- yes, definitely. Once you are out of equilibrium the process of getting back into equilibrium again is generally a painful process in which you can hardly avoid going past the equilibrium point over to the other side. It is a wave movement. Indeed, you might say that the fighting of the over-expenditure of the Korea boom has been one of the causes of a kind of recession after that in 1952-1953. We, therefore, had a period of too high unemployment, and then there were periods in which we started to introduce again an expansionary policy. That was in a period when we [illegible] the big deficits we had after the

boom period.

COMMISSIONER GIBSON: How much of an increase in your cost of living have you had since 1950?

DR. HOLTROP: I would not know it since 1950, but I think since 1953 our increase in the cost of living has been 24 per cent. That is rather high.

COMMISSIONER GIBSON: That is about 2 per cent a year.

DR. HOLTROP: Yes, or 2½ per cent a year. It is in that neighbourhood. This increase in the cost of living in Holland is, in my opinion, part of the process of increasing real wages also, because wages in that same period went up by some 60 per cent. The increase in the cost of living was, of course, partly the result of services getting more expensive as a consequence of the increase in wages, and also of controlled prices gradually being adapted to the new conditions, and in this respect I am thinking especially of house rents which although still under control have periodically been increased which has, therefore, increased the cost of living.

COMMISSIONER GIBSON: In other words, you would say part of the increase in the cost of living is not real in the sense that it simply reflects higher wages that are being paid for services?

DR. HOLTROP: It was real in a sense, but it was unavoidable in a way if you look at it on the basis of stable international prices.

COMMISSIONER GIBSON: Is that a tolerable situation, Dr. Holtrop -- that is, an average increase of

[illegible]

[illegible]ER GIBSON: How much of an increase [illegible] have you had since 1950?

DR. [illegible]

but I think since 1953 our increase in the cost of living has been 24 per cent. That is rather high.

COMMISSIONER GIBSON: That is about 2 per cent a year.

DR. HOLTROP: Yes, or 2½ per cent a year. It is in that neighbourhood. This increase in the cost of living in Holland is, in my opinion, part of the process of increasing real wages also, because wages in that same period went up by some 60 per cent. The increase in the cost of living was, of course, partly the result of services getting more expensive as a consequence of the increase in wages, and also of controlled prices gradually being adapted to the new conditions, and in this respect I am thinking especially of house rents which although still under control have periodically been increased which has, therefore, increased the cost of living.

COMMISSIONER GIBSON: In other words, you would say part of the increase in the cost of living is not real in the sense that it simply reflects higher wages that are being paid for services?

DR. HOLTROP: It was real in a sense, but it was unavoidable in a way if you look at it on the basis of [illegible]

COMMISSIONER GIBSON: Is that a tolerable [illegible]trop -- that is, an average increase of

$2\frac{1}{2}$ per cent per year?

DR. HOLTROP: I do not consider it in the long run as a tolerable situation at all, but I think under the conditions it was an unavoidable situation. I think that in the process of international adaptation those kinds of periods may occur. I do not consider it a tolerable situation in the long run because it would imply wage increases in the long run of at least 5 per cent a year. There are differences of opinion on this matter, but at the present time an increase of about $2\frac{1}{2}$ per cent per year per head of the population in real income has been normal.

We have had, over a longer period, already increases in real income of 4 per cent in total -- 1½ per cent being due to increases in population and, therefore, 2½ per cent being due to an increase in productivity. I would not be able to foresee whether in the long run we can expect that to continue, but were it to continue, on top of that you would have to have a 2½ per cent price increase, which would mean you would have to have about a 5 per cent wage increase a year. I cannot believe in the possibility of maintaining the equilibrium in your whole economy on the basis of that high yearly wage increase, because it means you also cannot forget the university professors and the other people, but no government thinks in those terms, so your whole system of prices and wages experiences a terrible tension, if you are to continually have that increase. It also brings up the problem of whether your banking system can inflate that high in the long run, so I hope it would be possible to have stable prices and, indeed, an increase in real income that would be matched by an increase in nominal incomes.

THE CHAIRMAN: Dr. Holtrop, is it possible to measure the increase in productivity of a university professor?

DR. HOLTROP: No. University professors and all functionaries of government have a productivity that is measured by their income. The national accounts do not allow us to do it differently.

We have had, over a longer period, already increases in real income of 4 per cent in total -- $1\frac{1}{2}$ per cent being due to increases in population and, therefore, $2\frac{1}{2}$ per cent being due to an increase in productivity. I would not be able to foresee whether in the long run we can expect that to continue, that were it to continue, on top of that you would have to have a $2\frac{1}{2}$ per cent price increase, which would mean you would have to have about a 5 per cent wage increase a year. I cannot believe in the possibility of maintaining the equilibrium in your whole economy on the basis of that high yearly wage increase, because it means you also cannot forget the university professors and the other people, but no government thinks in those terms, so your whole system of prices and wages experiences a terrible tension, if you are to continually have that increase. It also brings up the problem of whether your banking system can inflate that high in the long run, so I hope it would be possible to have stable prices and, indeed, an increase in real income that would be matched by an increase in nominal incomes.

THE CHAIRMAN: Dr. Holtrop, is it possible to measure the increase in productivity of a university professor?

DR. HOLTROP: No. University professors and all functionaries of government have a productivity that is measured by their income. The national accounts do not allow us to do it differently.

THE CHAIRMAN: You mentioned the service industries as being responsible for a considerable proportion of the increase in wages.

DR. HOLTROP: No, in the cost of living.

THE CHAIRMAN: Yes, in the cost of living. Well, how would you measure the productivity of persons in the service industries? As I recollect the situation, some years ago in the service industries they were, on the whole, very poorly paid -- poorly paid, perhaps, largely because of the supply and demand situation for that sort of labour, they were plentiful. More recently they have become less plentiful, and they hold out for higher wages. Perhaps they are not doing more per dollar, or per whatever the currency may be, but there may not be an increase in productivity relatively to what they did a few years ago. But is it not inevitable that when the demand and supply situation changes for labour of that kind that wages will rise?

DR. HOLTROP: No, I would not be able to give you the answer to that question, because if I asked the same question at home I would turn to my statisticians and they would not be able to answer, and then I would ask them to go to the Central Bureau of Statistics, to find out how, in a special case, they make the split-up between volume and price. That is easy to do in the case of manufactured products that continue in the same character. However, if you have changes in character it becomes more difficult. If you cannot make the split between price

THE CHAIRMAN: You mentioned the service [illegible]

[illegible]

DR. HOLTROP: No, in the cost of living.

THE CHAIRMAN: Yes, in the cost of living. Well, how would you measure the productivity of persons in the service industries? As I recollect the situation, some years ago in the service industries they were, on the whole, very poorly paid -- poorly paid, perhaps, largely because of the supply and demand situation for that sort of labour; they were plentiful. More recently they have become less plentiful, and they hold out for higher wages. Perhaps they are not doing more per dollar, or per whatever the currency may be, but there may not be an increase in productivity relatively to what they did a few years ago. But is it not inevitable that when the demand and supply situation changes for labour of that kind that wages will rise?

DR. HOLTROP: No, I would not be able to give you the answer to that question, because if I asked the same question at home I would turn [illegible] answer, and then I would ask them to go to the Central Bureau of Statistics, to find out how, in a special case, they make the split-up between volume and price. That is easy to do in the case of manufactured products that continue in the same character. However, if you have changes in character it becomes more difficult. If you cannot make the split between price

and quantity, then you have to give up -- as you cannot do in the case of government functionaries. It is a question of statistical technique, where I would not be able to give you the exact reply. I think there are cases also in service industries where it is possible to distinguish between quantity and price.

THE CHAIRMAN: It may be that the wages of the service industries have substantially increased over that period, but it does it also apply to the wages in agriculture and other industries?

DR. HOLTROP: Yes, in our country. In our country the wage level is rather homogeneous, but that is exceptional, because we are such a small country, and it has, moreover, been the policy of labour and government to make wages homogeneous.

THE CHAIRMAN: But there has been an increase in productivity of agriculture, from what you have said?

DR. HOLTROP: Yes.

THE CHAIRMAN: There are fewer but they are producing more?

DR. HOLTROP: Yes.

THE CHAIRMAN: It may be so in industry generally, but with the service industries, how do you measure it?

DR. HOLTROP: I would not be able to give the answer because you would have to go into specific industries to ask the question, and the statisticians and the people who make the national

and quantity, then you have to give up -- as you cannot do in the case of government functionaries. It is a question of statistical technique, where I would not be able to give you the exact reply. I think there are cases also in service industries where it is possible to distinguish between quantity and price.

THE CHAIRMAN: It may be that the wages of the service industries have substantially increased over that period, but it does it also apply to the wages in agriculture and other industries?

DR. HOLTROP: Yes, in our country. In our country the wage level is rather homogeneous, but that is exceptional, because we are such a small country, and it has, moreover, been the policy of labour and government to make wages homogeneous.

THE CHAIRMAN: But there has been an increase in productivity of agriculture, from what you have said?

DR. HOLTROP: Yes.

THE CHAIRMAN: There are fewer but they are producing more?

DR. HOLTROP: Yes.

THE CHAIRMAN: It may be so in industry generally, but with the service industries, how do you measure it?

DR. HOLTROP: I would not be able to give the answer because you would have to go into specific industries to ask the question, and the statisticians and the people who make the national

account are able to make the distinction between quantity and price; and if they cannot, you cannot measure it.

THE CHAIRMAN: The price for farm products in the Netherlands, have they risen in comparison to the rise in agricultural wages?

DR. HOLTROP: "Foreign" products? Is that what you said?

THE CHAIRMAN: "Farm" products -- agriculture.

DR. HOLTROP: Yes, in a way they have. That is a difficult subject again, because part of the farm produce is not a free price, and part is. We have also a system of agricultural price support for five main farm products, where indeed the government will allow the price to be raised. For the rest, prices are free, and may or may not go up. For example, the price of fruit and vegetables is completely free.

THE CHAIRMAN: But generally?

DR. HOLTROP: Generally, they have been playing a big role in the increase of prices. Farm products have risen much more than industrial products internally, within the country.

THE CHAIRMAN: Have industrial products risen very much?

DR. HOLTROP: No, they have been remarkably stable. They have some, but not very much. The figures I know by heart are since about 1953 -- and it is fair to talk only about that, since

account are able to make the distinction between quantity and price; and if they cannot, you cannot [illegible] it.

THE CHAIRMAN: The price for farm products in the Netherlands, have they risen in comparison to the rise in agricultural wages?

DR. HOLTROP: "Foreign" products? Is that what you said?

THE CHAIRMAN: "Farm" products -- agriculture.

DR. HOLTROP: Yes, in a way they have. That is a difficult subject again, because part of the farm produce is not a free price, and part is. We have also a system of agricultural price support for five main farm products, where indeed the government will allow the price to be raised. For the rest, prices are free, and may or may not go up. For example, the price of fruit and vegetables is completely free.

THE CHAIRMAN: Not generally?

DR. HOLTROP: Generally, they have been playing a big role in the increase of prices. Farm products have risen much more than industrial products internally, within the country.

THE CHAIRMAN: Have industrial products risen very much?

DR. HOLTROP: No, they have been remarkably stable. They have some, but not very much. The figures I know by heart are since about 1953 -- and it is fair to talk only about that, since

1953, because you may remember that Holland joined with the devaluation of Britain in 1949, and that was a very big devaluation, one which was only worked off in prices in the course of the next few years. So that the period between 1949 and, let us say, 1953 has been very much under the influence of devaluation also, so that it was not a period of stability.

COMMISSIONER GIBSON: Going back to the question of what is a tolerable price increase, you answered by saying that in the future you hope there would not be any price increase. In view of the fact you mentioned services which are to a large degree labour and wages, will increase with rising productivity in other sections of the economy, pushing up wages for services, even if productivity is not rising there, is this a possible eventuality? This implies that the price of goods will have to decline, but the price of services will probably go up.

DR. HOLTROP: Certainly, in my opinion, the price of industrial goods where the increase in productivity exceeds the average, ought to go down and create a compensation there for the increase in the services. Unless you look upon it from the national point of view, it is not a matter of arithmetic, there you have to more or less adapt yourself to an international price level and build up your own price level on the basis of the international one. When I say that I would hope the cost of living in the long run would be stable,

1953, because you may remember that Holland joined with the devaluation of Britain in 1949, and that was a very big devaluation, one which was only worked off in prices in the course of the next few years. So that the period between 1949 and, let us say, 1953 has been very much under the influence of devaluation also, so that it was not a period of stability.

COMMISSIONER GIBSON: Going back to the question of what is a tolerable price increase. you answered by saying that in the future you hope there would not be any price increase. In view of the fact you mentioned services which are to a large degree labour and wages, will increase with rising productivity in other sections of the economy, pushing up wages for services, even if productivity is not rising there, is this a possible eventuality? This implies that the price of goods will have to decline, but the price of services will probably go up.

DR. HOLTROP: Certainly, in my opinion, the price of industrial goods where the increase in productivity exceeds the average, ought to go down and create a compensation there for the increase in the services. Unless you look upon it from the national point of view, it is not a matter of arithmetic, there you have to more or less adapt yourself to an international price level and build up your own price level on the basis of the international one. When I say that I would hope the cost of living in the long run would be stable,

again that is a declaration of an ideal you would not expect to be able, at any rate, to influence yourself to a very large extent; that will be the result of international conditions. I can only say that if you do not get near to those conditions you will be faced again in the long run with problems of international parities, because you will come to the point where some countries will be reluctant to follow that international price increase, and where you get tensions in the field of parities.

COMMISSIONER GIBSON: Do you feel that the general world price outlook is still strongly inflationary?

DR.HOLTROP: No. I think that in the last four years it has been remarkably stable.

COMMISSIONER GIBSON: Would you agree with Per Jacobsen in his view that the great inflationary forces have pretty much diminished now?

DR. HOLTROP: I would agree with him that it is a fact that international price levels in the last four years have been satisfactorily stable.

COMMISSIONER GIBSON: Let us put it another way: do you think that the outlook for the next decade is less inflationary than the last?

DR. HOLTROP: I would expect that also to be the case, because I think the last decade has been under the influence of conditions established in the after-war years, and the after-

again that is a declaration of an ideal you would not expect to be able, at any rate, to influence yourself to a very large extent; that will be the result of international conditions. I can only say that if you do not get near to those conditions you will be faced again in the long run with problems of international parities, because you will come to the point where some countries will be reluctant to follow that international price increase, and where you get tensions in the field of parities.

COMMISSIONER GIBSON: Do you feel that the general world price outlook is still strongly inflationary?

DR. HOLTROP: No. I think that in the last four years it has been remarkably stable.

COMMISSIONER GIBSON: Would you agree with Per Jacobsson in his view that the great inflationary forces have pretty much diminished now?

DR. HOLTROP: I would agree with him that it is a fact that international price levels in the last four years have been satisfactorily stable.

COMMISSIONER GIBSON: Let us put it another way: do you think that the outlook for the next decade is less inflationary than the last?

DR. HOLTROP: I would expect that also to be the case, because I think the last decade has been under the influence of conditions established in the after-war years, and the after-

war excess liquidity. But I also feel it is a constant fight and, therefore, you cannot predict too definitely because it will all be the outcome of policies to be followed by governments. Nobody knows what policies governments are going to follow -- at any rate, not that surely.

COMMISSIONER GIBSON: It is a change in concept quite a bit, because we have talked about the problems of inflation and the rise in prices.

DR. HOLTROP: Yes.

COMMISSIONER GIBSON: What about the conflict between your two-fold objective of maintaining internal and external value of the currency unit when conditions at home are deflationary, when you have unemployment and when your exchange rate is embarrassingly high? This is the position we found ourselves in a little while ago. I take it that it is not a position you have been in in Holland, from your memorandum. Would you care to say anything about how far you think a country ought to defend the value of its currency?

DR. HOLTROP: In a general way, I would be willing to say this about it: I think it would be a question of proper analysis of the situation -- with all the difficulties of that type of analysis. But you can come into conflict as a consequence of your own policies. You may come into a situation, if you have followed yourself inflationary

war excess liquidity. But I also feel it is a constant fight and, therefore, you cannot predict too definitely because it will all be the outcome of policies to be followed by governments. Nobody knows what policies governments are going to follow -- at any rate, not that surely.

COMMISSIONER GIBSON: It is a change in concept quite a bit, because we have talked about the problems of inflation and the rise in prices.

DR. HOLTROP: Yes.

COMMISSIONER GIBSON: What about the conflict between your two-fold objective of maintaining internal and external value of the currency unit when conditions at home are deflationary, when you have unemployment and when your exchange rate is embarrassingly high? This is the position we found ourselves in a little while ago. I take it that it is not a position you have been in in Holland, from your memorandum. Would you care to say anything about how far you think a country ought to defend the value of its currency?

DR. HOLTROP: In a general way, I would be willing to say this about it: I think it would be a question of proper analysis of the situation -- with all the difficulties of that type of analysis. But you can have this conflict as a [illegible] of your own policies. You may come into a situation, if you have followed yourself inflationary

policies in a neutral world -- you are bound to find yourself in a balance of payment deficit, and you may have to ask, "What about the choice between internal and external stability?". In the early stages of that situation it is quite clear that external stability should prevail, and that you should stop following inflationary policies. It is also possible, we have known that in the thirties, that your balance of payment deficit is not caused by your own inflation but by world deflation. That is very hard, because that condition ought to be fought by monetary policies in the rest of the world, but you cannot decide about those policies. Therefore, the choice between using the change in the rate or not is a different one than in the case where you have the choice of your own monetary policies that might control the situation. This has been the dilemma in which several countries found themselves in the thirties. We ourselves, at one stage, had to decide to devalue the currency because in that deflationary world we could not possibly, by our own policies, maintain the parity without continuing to deflate within the country also.

Now, the other case is that the disparity which comes out in your balance of payment situation is not at all the consequence of monetary conditions, but is a consequence of shifts in international demand. That is a completely different situation of course, and under those circumstances I can very

policies in a [illegible] yourself in a balance of payment deficit, and you may have to ask, "What about the choice between internal and external stability?". In the early stages of that situation it is quite clear that external stability should prevail, and that you should stop following inflationary policies. It is also possible, we have known that in the thirties, that your balance of payment deficit is not caused by your own inflation but by world deflation. That is very hard, because that condition ought to be fought by monetary policies in the rest of the world, but you cannot decide about those policies. Therefore, the choice between using the change in the rate or not is a different one than in the case where you have the choice of your own monetary policies that might control the situation. This has been the dilemma in which several countries found themselves in the thirties. We ourselves, at one stage, had to decide to devalue the currency because in that deflationary world we could not possibly, by our own policies, maintain the parity without continuing to deflate within the country also.

Now, the other case is that the disparity which comes out in your balance of payment situation is not at all the consequence of monetary conditions, but is a consequence of shifts in international demand. That is a completely different situation. Of course, and under those circumstances I am very

well see the possibility of conditions where a country comes to the conclusion that international demand has made shifts which are long-run and which are not expected to change very much, and as a consequence it is left with a rate of exchange that cannot be expected to be an equilibrium rate in the future. Under those conditions it might be better to change the rate than to deflate, in order to get into equilibrium again. The same holds true of the reverse, as in the case of Holland and Germany two years ago. We only followed Germany; we, as a small country, would not have taken this decision above. But, there again, a country can be faced with the dilemma of allowing a further internal price-wage inflation, or perhaps rather change the rates and have it done with that change of rate. Theoretically, these problems can come up, and in the future countries can be faced with this type of decision. We know, on the other hand, through international experience, that there always should be a certain bias for maintaining the rate, because a change in rate is, after all, a very painful procedure and also causes, or may cause, all sorts of disturbances. However, I do not think you can give a general answer to that question. Every country, then, has to judge its own situation and to know what it can do with one instrument, or what it might do with the other instrument, and has to choose between the two.

not expected to change very much, and as a consequence it is left with a rate of exchange that cannot be expected to be an equilibrium rate in the future. Under those conditions it might be better to change the rate than to deflate, in order to get into equilibrium again. The same holds true of the reverse, as in the case of Holland and Germany two years ago. We only followed Germany; we, as a small country, would not have taken this decision above. But, there again, a country can be faced with the dilemma of allowing a further internal price-wage inflation, or perhaps rather change the rates and have it done with that change of rate. Theoretically, these problems can come up, and in the future countries can be faced with this type of decision. We know, on the other hand, through international experience, that there always should be a certain bias for maintaining the rate, because a change in rate is, after all, a very painful procedure and also causes, or may cause, all sorts of disturbances. However, I do not think you can give a general answer to that question. Every country, then, has to judge its own situation and to know what it can do with one instrument, or what it might do with the other instrument, and has to choose

COMMISSIONER GIBSON: Thank you very much. I have no further questions.

--- Short recess.

COMMISSIONER MACKINTOSH: Dr. Holtrop, I would like to ask you some rather elementary questions to clear up my understanding of your techniques of monetary policy. I take it from the memorandum which you have submitted that discount policy is not a particularly strong item in your list of techniques. You mention the banks at times are not discounting with the central bank: does the central bank at times force the banks into central bank credit? The Federal Reserve in America has done this. The Bank of England used to bring the market in.

DR. HOLTROP: No. In that respect Holland is a somewhat difficult example for other countries because of the special conditions prevailing in Holland which, in a way, are comparable to conditions prevailing in a small country like Switzerland. The discount rate is not a rate that is usually effective in the sense of controlling market rates, and it is not effective because the banks normally do not need central bank credit.

The cause of these conditions which prevail also in some other small countries -- but Holland and Switzerland are good examples -- is that the foreign exchange holdings of the central bank, the reserves of the country, are normally quite a bit larger than the monetary circulation in the sense of the bank note circulation. So, if you take the balance sheet of the central bank and also take into consideration we do not hold an equalization fund asset -- it is the central bank that holds the foreign exchange reserves -- you will find on the one hand gold and foreign exchange, and on the

[illegible]: Dr. Holtrop, I would like to ask you some rather elementary questions to clear up my understanding of your techniques of monetary policy. I take it from the memorandum which you have submitted that discount policy is not a particularly strong item in your list of techniques. You mention the banks at times are not discounting with the central bank: does the central bank at times force the banks into central bank credit? The Federal Reserve in America has done this. The Bank of England used to bring the market in.

DR. HOLTROP: No. In that respect Holland is a somewhat difficult example for other countries because of the special conditions prevailing in Holland which, in a way, are comparable to conditions prevailing in a small country like Switzerland. The discount rate is not a rate that is usually effective in the sense of controlling market rates, and it is not effective because the banks normally do not need central bank credit.

The cause of these conditions which prevail also in some other small countries -- but Holland and Switzerland are good examples -- is that the foreign exchange holdings of the central bank, the reserves of the country, are normally quite a bit larger than the monetary circulation in the sense of the bank note circulation. So, if you take the balance sheet of the central bank and also take into consideration we do not [illegible] that [illegible] foreign exchange reserves [illegible] gold and foreign exchange, and on the

other hand you find the bank note circulation which is lower, and then you find on the liabilities side some government deposits and some deposits by the banking community. That is the whole story of the balance sheet of the central bank. The private banks, the market, does not play a role in that balance sheet any more. The Bank does not play an active role in the market except that it has also a small portfolio of short-term government paper with which it can operate on the market. So, there is a possibility of open market policies, but not to a very large extent.

This condition means that the market rate on the short-term market is more or less conditioned by the international situation also, because the banks have the choice of investing in the home market or in the foreign money market and then cover their exchange risk. They will do either one or the other as circumstances permit and as the rates are. It means that the market rate, as distinguished from the formal discount rate, is more or less conditioned by the situation in other countries, by the market rates prevailing, elsewhere, and by the conditions on the market for foreign exchange, because banks will not take exchange riaks as a rule. So, if a Dutch bank chooses to hold part of its liquidity either externally or internally -- London or New York, or wherever the market is -- it will cover the exchange risk and therefore it has to deduct from the gross interest the cost of the swap

... find the bank note circulation which
... then you find on the liabilities side
... deposits and some deposits by the
... That is the whole story of
the balance sheet of the central bank. The private
banks, the market, does not play a role in that
balance sheet any more. The Bank does not play
an active role in the market except that it has also
...
which it can operate on the market. So, there is a
possibility of open market policies, but not to a very
large extent.

This condition means that the market rate
on the short-term market is more or less conditioned
by the international situation also, because the
banks have the choice of investing in the home market or
in the foreign money market and then cover their exchange
risk. They will do either one or the other as circumstances
permit and as the rates are. It means that the market
rate, as distinguished from the formal discount rate,
is more or less conditioned by the situation in other
countries, by the market rates prevailing elsewhere,
and by the conditions on the market for foreign
exchange, because banks will not take exchange
risks as a rule. So, if a Dutch bank chooses to
hold part of its liquidity either externally or
internally -- London or New York, or wherever th...
...
...efore it has to ... from the ...

It is in that way this market rate is fixed. The market rate is the consequence of a situation of a rather liquid situation or the situation in a country itself, because the foreign exchange reserves are, relative to the bank-note circulation, high. They are not by themselves high. Our foreign exchange reserves do not exceed four months imports. If I remember correctly, it is even a figure which is much lower than yours. Your imports and exports are high, and if I remember rightly yours used to be on six months exports -- there used to be $2 billion.

COMMISSIONER MACKINTOSH: They are now.

DR. HOLTROP: Yes. So, the four months by itself is not high, but that is the normal situation. Under conditions of balance of payments deficits you will find the banks lose deposits because deposits are being used by the private sector of the economy to pay for the excess of imports. So, the liquidity of the banks in the case of a balance of payments deficit is rather quickly reduced, and that may create a situation in which the bank has to turn to the central bank to be accommodated by the central bank.

It was a condition which was quite naturally caused in, for example, 1956-1957, the last time we had a real big balance of payment deficit, and conditions had to be tightened on the market. So, in that year it was possible to increase the bank rate and have it completely effective. The banks had to pay the higher rate and it worked all through the market.

There are other situations in which we have

It is in that way this market rate is fixed. The market rate is the consequence of a situation of a rather liquid situation or the situation in a country itself, because the foreign exchange reserves are relative to the bank-note circulation high. They are not by themselves high. Our foreign exchange reserves do not exceed four months imports. If I remember correctly, it is even a figure which is much lower than yours. Your imports and exports are high, and if I remember rightly yours used to be on six months exports -- there used to be [illegible].

COMMISSIONER MACKINTOSH: They are now.

DR. HOLTROP: Yes. So, the four months by itself is not high, but that is the normal situation. Under conditions of balance of payments deficits you will find the banks lose deposits because deposits are being used by the private sector of the economy to pay for the excess of imports. So, the liquidity of the banks in the case of a balance of payments deficit is rather quickly reduced, and that may create a situation in which the bank has to turn to the central bank to be accommodated by the central bank.

It was a condition which was quite naturally caused in, for example, 1956-1957, the last time we had a real big balance of payment deficit, and conditions had to be tightened on the market. So, in that year it was possible to increase the bank rate and have it completely effective. The banks had to pay the higher rate and it worked all through the market.

There are other situations in which we have

tried, you might say, tricks. We have artificially created conditions in which the bank rate would work that way. We did that, for example, in the Korean crisis. In the Korean crisis the banks also were still very liquid because they held a vast amount, or a large amount, of short-term government paper and could easily, when the balance of payment deficit led to a withdrawal of funds from the banks, have financed themselves by letting the short-term government paper run off, and then it would have been the government in trouble and not the banks. The government would have to turn to the market and create conditions where the discount rate would also have to become effective.

At that moment we made special rulings: we agreed with the banks, and they took it upon themselves not to liquidate their short-term government holdings, but in case of either exceeding a certain ceiling of credit expansion or going down below a certain level of liquidity they would borrow from the bank for the excess. So, by convention we forced the banks to borrow from the Bank to make the rate effective.

So, there are situations in which, by artificial means, we have made the rate effective. There are situations, but only in cases of strong balance of payments deficits, where the rate becomes effective, but under the normal conditions the rate is not effective in the sense it controls the market rate. It does, however, yet have an influence which is of some importance, because the rates the commercial banks charge for their loans to clients is mostly based on the

tried, you might say, tricks. We have artificially created conditions in which the bank rate would work that way. We did that, for example, in the Korean crisis. In the Korean crisis the banks also were still very liquid because they held a vast amount, or a large amount, of short-term government paper and could easily, when the balance of payment deficit led to a withdrawal of funds from the banks, have financed themselves by letting the short-term government paper run off; and then it would have been the government in trouble and not the banks. The government would have to turn to the market and create conditions where the discount rate would also have to become effective.

At that moment we made special rulings: we agreed with the banks, and they took it upon themselves not to liquidate their short-term government holdings, but in case of either exceeding a certain ceiling of credit expansion or going down below a certain level of liquidity they would borrow from the bank for the excess. So, by convention we forced the banks to borrow from the Bank to make the rate effective.

So, there are situations in which, by artificial means, we have made the rate effective. There are situations, but only in cases of strong balance of payments deficits, where the rate becomes effective, but under the normal conditions the rate is not effective in the sense it controls the market rate. It does, however, yet have an influence which is of some importance, because the rates the commercial banks charge for their loans to clients is mostly based on the

Bank rate. They will have a rate, for example, of 1½ per cent above the bank rate with a minimum of say 4½ per cent. So, that means if the bank rate is increased beyond 3 per cent they will increase the rate charged to the customers. At the present time, since 1961 as a matter of fact, when we increased the bank rate because we considered it necessary from the point of view of monetary policy to exert a certain restrictive influence, we have increased the bank rate to 4 per cent, and it had been 2-3/4 per cent in the period before that. We increased it in two steps to 4 per cent and this led to an increase also in the cost of bank loans to the public.

So, in that indirect way it became effective. However, the market rate is fluctuating at the present time. It has been seven-eighths of one per cent for a short period, and it has been up to 2 per cent, but it has never in the last two years gone much higher than that. In the last two years it has been fluctuating, you might say, between one and, I think, 2½ per cent. The market rate is well below the bank rate.

COMMISSIONER MACKINTOSH: You have already indicated that open market policy has a pretty small role in your operations?

DR. HOLTROP: Yes.

COMMISSIONER MACKINTOSH: Would I be right in concluding that your major weapon is this variation of the cash reserves?

DR. HOLTROP: No, it would not be fair to put it that way because our cash reserve system is actually

Bank rate. They will pay a rate, for example, of 1½ per cent above the bank rate with a minimum of say 4½ per cent. So, that means if the bank rate is increased beyond 3 per cent they will increase the rate charged to the customers. At the present time, since 1961 as a matter of fact, when we increased the bank rate because we considered it necessary from the point of view of monetary policy to exert a certain restrictive influence, we have increased the bank rate to 4 per cent, and it had been 2-3/4 per cent in the period before that. We increased it in two steps to 4 per cent and this led to an increase also in the cost of bank loans to the public.

So, in that indirect way it became effective. However, the market rate is fluctuating at the present time. It has been seven-eighths of one per cent for a short period, and it has been up to 2 per cent, but it has never in the last two years gone much higher than that. In the last two years it has been fluctuating, you might say, between one and, I think, 2½ per cent. The market rate is well below the bank rate.

COMMISSIONER MACKINTOSH: You have already indicated that open market policy has a pretty small role in your operations?

DR. HOLTROP: Yes.

COMMISSIONER MACKINTOSH: Would I be right in concluding that your major weapon is this variation of the cash reserves?

DR. HOLTROP: No, it would not be fair to put it that way because our cash reserve system is actually

based on a gentlemen's agreement with the banks, and the basic idea of a gentlemen's agreement was not that we should use the cash reserves as a method of constraining the banks, but that we should use it as an additional means of open market policy. You really have to look upon our cash reserve system as an additional form of open market policy. We actually do it this way, that at a certain moment -- and there again you have to think of the balance of payments -- if our balance of payments is in surplus it means we get an influx of foreign exchange, and we take over the foreign exchange from the banks, and the banks get their liquidity, and they have to place these funds on the foreign market, if they can, but then, they don't sell the foreign exchange to us. However, if there is no opportunity to place it on the foreign market they have to put it on the home market, and we can do two things: we may sell short-term paper out of our own portfolio to give the banks the opportunity of investing the surplus, and at the same time we can increase the cash ratio to absorb the other part. The reverse will take place when we have temporarily a period of balance of payments deficit. Then again, we will give the barks back some of their liquidity by lowering the cash reserve ratio, and at the same time buying from them some short-term paper out of their portfolio. It is not only the balance of payments that has to be taken into consideration; it is also the fluctuation in the account of the treasury. The treasury only keeps its account with the central bank, not with the private banks.

on a gentlemen's agreement with the banks, and the basic idea of a gentleman's agreement was not that we should use the cash reserves as a method of constraining the banks, but that we should use it as an additional means of open market policy. You really have to look upon our cash reserve system as an additional form of open market policy. We actually do it this way, that at a certain moment -- and there again you have to think of the balance of payments -- if our balance of payments is in surplus it means we get an influx of foreign exchange, and we take over the foreign exchange from the banks, and the banks get their liquidity, and they have to place those funds on the foreign market, if they can, but then, they don't sell the foreign exchange to us. However, if there is no opportunity to place it on the foreign market they have to put it on the home market, and we can do two things: we may sell short-term paper out of our own portfolio to give the banks the opportunity of investing the surplus, and at the same time we can increase the cash ratio to absorb the other part. The reverse will take place when we have temporarily a period of balance of payments deficit. Then again, we will give the banks back some of their liquidity by lowering the cash reserve ratio, and at the same time buying from them some short-term paper out of their portfolio. It is not only the balance of payments that has to be taken into consideration: it is also the fluctuation in the account of the treasury. The treasury only keeps its account with the central bank, not with the private banks.

I think in your country they can also hold deposits with private banks. The treasury can be seasonably in surplus. We have tax payments especially between September and December when the treasury runs up a balance with the Bank , and the consequence is that the money market gets tighter, and then again we use both open market policy and cash reserve ratio to give back some liquidity to the banking system.

COMMISSIONER MACKINTOSH: I am not quite clear in what respect your agreement with the banks limits its policy. Is it that you undertake to use both so that the private banks' earning power is not seriously prejudiced?

DR. HOLTROP: There is something to that, but it is also a matter of quantity. Our open market portfolio -- you might say the amount of credit which we still give to the government, has gradually gone down to an immense degree. Just after the war we started with an open market protfolio of some three billion guilders. That was the result of the war inflation, really, which we had gone through, and the government has gradually paid back its debt to the bank. So that, our open market portfolio has gradually decreased, and our foreign exchange reserves have gradually increased. So, in our balance sheet of the bank the open market portfolio has been replaced by foreign exchange reserves. The small open market portfolio, therefore, limits the opportunity of using open market policy for the central bank and with a portfolio of only a few hundred million guilders we cannot exert a very strong influence on the market,

think in your country they can also hold deposits with private banks. The treasury can be seasonably surplus. We have tax payments especially between September and December when the treasury runs up a balance with the Bank, and the consequence is that the money [illegible] market policy and cash reserve ratio to give back some liquidity to the banking system.

COMMISSIONER MACKINTOSH: I am not quite clear in what respect your agreement with the banks limits its policy. Is it that you undertake to use both so that the private banks' earning power is not seriously [illegible]

DR. HOLTROP: There is something to that, but it is also a matter of quantity. Our open market portfolio -- you might say the amount of credit which we still give to the government, has gradually gone down to an immense degree. Just after the war we started with an open market portfolio of some three billion guilders. That was the result of the war inflation, really, which we had gone through, and the government has gradually paid back its debt to the bank. So that, our open market portfolio has gradually decreased, and our foreign exchange reserves have gradually increased. So, in our balance sheet of the bank the open market [illegible] opportunity of using open market policy for the central and with a portfolio of only a few hundred million guilders cannot exert a very strong influence on the market,

and therefore need an additional means. We had to agree with the banks to get that: we made a gentlemen's agreement to get that result, and that gentlemen's agreement took also into consideration the interest of the banks themselves, and therefore led to that situation in which we agreed we should, about 50/50, make use of both means in case of need.

You may ask as a consequence, what, then, is our restraining policy? What means do we have to exert an influence on the banks ? The answer is that we have to make use of quantitative measures. We have to agree with the banks on certain ceilings for their credit expansion, because the normal market means cannot very well be used in a country where the central bank keeps the foreign exchange reserves, and where the foreign exchange reserves then exceed the bank-note circulation. You will find in countries where those conditions prevail that the central bank has difficulties in controlling the money market, and that these are countries where usually the money market rates are low. Switzerland and Holland are the big examples there.

COMMISSIONER MACKINTOSH: Yes. What you say with respect to agreements with the bank was what I wanted to raise next. My recollection is that while you have power to give directives you have not used it, but rather you have preferred to make agreements with the banks?

and [illegible] need an additional means. We had to agree all [illegible] to get that: we made a gentleman's agreement to get that result, and that gentleman's agreement took also into consideration the interest of the banks themselves, and therefore led to that situation in which we agreed we should, about 50/50, make use of both means in case of need.

You may ask as a consequence, what, then, is our restraining policy? What means do we have to exert an influence on the banks ? The answer is that we have to make use of quantitative measures. We have to agree with the banks on certain ceilings for their credit expansion, because the normal market means cannot very well be used in a country where the central bank keeps the foreign exchange reserves, and where the foreign exchange reserves then exceed the bank-note circulation. You will find in countries where those conditions prevail that the central bank has difficulties in controlling the money market, and that these are countries where usually the money market rates are low. Switzerland and Holland are the big examples there.

[illegible]: Yes. [illegible]

with respect to agreements with the bank was what I wanted to raise next. My recollection is that while you have power to give directives you have not used it, but rather you have preferred to make agreements with the banks?

DR. HOLTROP: The Bank Act and the Act of control of the credit system gives us certain powers, but it makes those powers conditional. That is to say, we either have to try to get agreement with the representative organizations of the banks about the measures we take, and then these measures are final and binding with the individual banks, or, if we don't get agreement with the banks, then we can act on our own with approval of the minister of finance, but the measures we take have then to be approved by parliament, they have to be introduced within three months to parliament for approval, so there is rather a strong check in our system on the possibilities of strong measures of central bank policy.

Now, the powers we have go rather far because we can declare certain ceilings, we can make rules about the relationship between liquid holdings and liabilities, we can go rather far in that respect if for reasons of monetary policy we think it is necessary. But on the other hand, the interest of the banks and the interest of the community is protected by this; either we have to do these things after consultation and agreement with the banks or we have to do it with explicit approval of the minister of finance, who then has to turn to parliament to get parliamentary approval of that.

COMMISSIONER LEMAN: In such a case would it be normal for the governor himself to appear before parliament to defend it?

DR. HOLTROP: The Bank Act and the Act of control of the credit system gives us certain powers, but it makes those powers conditional. That is to say, we either have to try to get agreement with the representative organizations of the banks about the measures we take, and then these measures are final and binding with the individual banks, or, if we don't get agreement with the banks, then we can act on our own with approval of the minister of finance, but the measures we take have then to be approved by parliament, they have to be introduced within three months to parliament for approval, so there is rather a strong check in our system on the [illegible] policy.

[illegible]

because we can declare certain ceilings, we can make rules about the relationship between liquid holdings and liabilities, we can go rather far in that respect if for reasons of monetary policy we think it is necessary. [illegible] interest of the banks and the interest of the community is protected by this; either we have to do these things after consultation and agreement with the banks or we have to do it with explicit approval of the minister of finance, who then has to turn to parliament to get parliamentary approval of that.

[illegible]

[illegible]

DR. HOLTROP: No, we don't have public appearances before parliament. We haven't your system of parliamentary committees; parliamentary committees don't hold hearings under our system of government so there has never been an occasion where the president of the bank gets in touch with parliament; it is the minister of finance who is responsible to parliament.

COMMISSIONER GIBSON: Have you ever taken such measures to parliament?

DR. HOLTROP: No. It is the same thing as wish the directive, this has never been used, and it is again a part of the system I think we developed in Holland where you have in a way a big stick in the background, the directive in the relationship between the government and the central bank, the measures to be taken by the central bank with the approval of the minister of finance in the relationship between the central bank and the banking system, which guarantees, in a way, that the consultations will lead to a result. I think if there wasn't that big stick behind that it would be very difficult to agree with the banks on measures which would, after all, be limiting on their activity. It is very difficult for them as private institutions to take the same public view as the central bank. On the other hand, knowing that it is possible that stronger measures be taken, they will try to come to an agreement with the bank, and that has worked out that way.

DR. HOLTROP: No, we don't have public appearances before parliament. We haven't your system of parliamentary committees; parliamentary [illegible] of government so there has never been an occasion where the president of the bank gets in touch with parliament; it is the minister of finance who is responsible to parliament.

COMMISSIONER GIBSON: Have you ever taken such measures to parliament?

DR. HOLTROP: No. It is the same thing as with the directive, this has never been used, and it is again a part of the system I think we developed in Holland where you have in a way a big stick in the background, the directive in the relationship between the government and the central bank, the measures to be taken by the central bank with the approval of the minister of finance in the relationship between the central bank and the banking system, which guarantees, in a way, that the consultations will lead to a result. I think if there wasn't that big stick behind them it would be very difficult to agree with the banks on measures which would, after all, be limiting on their activity. It is very difficult for them as private institutions to take the same public view as the central bank. On the other hand, knowing that it is possible that stronger measures be taken, they will try to come to an agreement with the bank, and that has worked out that way.

That is the result of the latest credit control Act which is the Act of 1954, and under the older law we had not got this system; there we had a system that the Bank had to have the approval of the minister of finance to take certain measures, and the banks had no say in it. The banks were in opposition to that system; they had always taken the position that these kind of measures could be made by a gentlemen's agreement, and that it was possible to make them by gentlemen's agreement. Under the old law we haven't made use of the legal powers, but we did develop certain gentlemen's agreements with the banks, and as a consequence of that we have also come to a change of law. So, in 1954, the law was changed in the direction of the wishes of the banks, and that in a way the system of the gentlemen's agreement was introduced as the first stage of monetary policy, and behind that you have the possibility of stronger measures, but I must make it clear that this all applies, of course, only to special powers of directive which the bank has.

If by natural causes the bank rate becomes effective, it leaves the bank free to give or not to give credit to certain banks, and it makes its own conditions when it gives credit to the banks. The special powers of directive are necessary in those conditions that the banks are not reall y dependent on the central bank for borrowing money, because then the bank might find itself up in the air in its possibilities of sufficiently influencing the banking

system.

COMMISSIONER BROWN: It is more than just moral suasion?

DR. HOLTROP: It is definitely more than moral suasion. We have tried moral suasion also and we have also had other experiences. When we were still at the first Act, which was rather a cumbersome thing, we tried also by moral suasion to influence the banks. The trouble is you never know how far it works. The banks will be open to it and you believe, of course, that it has a certain influence, but you are always in doubt as to how much. Moral suasion can't be put in quantitative terms, of course, and the powers we now have can be put in quantitative terms. For example, at the time we actually apply rates where the banks are allowed to increase the total of their loans by -- at the present moment we have a figure of ½ per cent per month, and if they exceed that figure they have to make special deposits which make it unprofitable for them to exceed those limits, so they try not to exceed them by any large extent. As a consequence you will have a quantitative measure and you have the feeling that the result of the measure is what you wanted to have.

COMMISSIONER BROWN: For how long a period has this one per cent per month been used?

DR. HOLTROP: It is ½ per cent per month. Only since the beginning of this year; the application of this type of control was only started

COMMISSIONER [illegible]: It is more than just moral suasion?

DR. HOLTROP: It is definitely more than moral suasion. We have tried moral suasion also and we have also had other experiences. When we were still at the first Act, which was rather a cumbersome thing, we tried also by moral suasion to influence the banks. The trouble is you never know how far it works. The banks will be open to it and you believe, of course, that it has a certain influence, but you are always in doubt as to how much. Moral suasion can't be put in quantitative terms, of course, and the powers we now have can be put in quantitative terms. For example, at the time we actually apply rates where the banks are allowed to increase the total of their loans by -- at the present moment we have a figure of ½ per cent per month, and if they exceed that figure they have to make special deposits which make it unprofitable for them to exceed those limits, so they try not to exceed them by any large extent. As a consequence you will have a quantitative measure and you have the feeling that the result of the measure is what you wanted to have.

COMMISSIONER BROWN: For how long a period has this one per cent per month been used?

DR. HOLTROP: It is ½ per cent per month. Only since the beginning of this year; the application of this type of control was only started

in July, 1961, so it is only somewhat more than a year that we now have this measure of quantitative limitation of the expansion of the credit of the banks.

COMMISSIONER BROWN: I wonder if you would also describe for us in some detail how you measure the reserves that they are to hold; what time lag is there between the definition of their requirements and what they have to have at all times?

DR. HOLTROP: The basis of the figures already used is a three months' moving average, so the ½ per cent applies to the three months' moving average, and therefore let us say the June figure with which we work is the average of the months of April, May and June, and this is referred to a basic period -- the basic period presently is the fourth quarter of 1960 -- and this is the basis on which the increase in loans is measured the month in which they have to make the special deposits, if they are in excess of the norm fixed by the bank, is the month directly after the figures have become available, so that means that the figures for the month of June will become available at the end of the month of July, and then in the month of August they will have to make the special deposits which will compensate for the excess in the month of June.

COMMISSIONER BROWN: It is a two and one-half month lag, if you take the average?

DR. HOLTROP: If you take the average, it is a two and one-half month lag but the average

in July, 1951, so it is only somewhat more than a year that we now have this measure of quantitative limitation the expansion of the credit of the banks.

COMMISSIONER BROWN: I wonder if you would [illegible] [illegible] the time lag is there between the definition of their requirements and what they have to have at all times?

DR. HOLTROP: The basis of the figures already used is a three months' moving average. So the ½ per cent applies to the three months' moving average, and therefore let us say the same figure with which we work is the average of the months of April, May and June, and this is referred to a basic period -- the basic period presently is the fourth quarter of 1960 -- and this is the basis on which the increase in loans is measured. The month in which they have to make the special deposits, if they are in excess of the norm fixed by the bank, [illegible] available, so that means that the figures for the month of June will become available at the end of the month of July, and then in the month of August they will have to make the special deposits which will compensate for the excess in the month of June.

COMMISSIONER BROWN: It is a two and one-half month lag, if you take the average.

DR. HOLTROP: If you take the average, it is a two and one-half month lag but the average

is, of course, the way to keep out a little bit the excess fluctuations and you might say that it is one and a half months also; it is just as you take it, but it is true because of this moving average the actual figure of June will only influence the calculating basis of the month of June for one-third.

COMMISSIONER BROWN: The other thing was you mentioned that the bank charges to their customers a rate of $1\frac{1}{2}$ per cent in excess of the banking rate. Is this by custom? Is there any statutory limit?

DR. HOLTROP: There is no statute whatever and I would say it is not an absolute rule; a large part of the loans made by the banks are however covered by this custom.

COMMISSIONER BROWN: It is the prime rate?

DR. HOLTROP: You might call it that. We don't use the notion of prime rate.. All the rates are quite competitive, and in a way nobody knows whatthe most favourable rate is that the bank will charge to the most favoured customer.

COMMISSIONER BROWN: Would you care to comment on the theory of a legislative ceiling on bank charges?

DR. HOLTROP: I must say that our experience with no legislative ceilings whatever has been favourable, and from what I have observed in the experience of other central banks and other banking systems I have tended to think that all these sorts of rules are dangerous in a way because you come

is, of course, the way to keep out a little bit the [illegible] fluctuations and you might say that it is one and a half month's also; it is just as you take it, but it is true because of this moving average the actual figure of June will only influence the calculating basis of the month of June for one-third.

COMMISSIONER BROWN: [illegible] was you mentioned that the bank charges to their customers a rate of 1½ per cent in excess of the banking rate. Is this by custom? Is there any statutory limit?

DR. HOLTROP: There is no statute whatever and I would say it is not an absolute rule; a large part of the loans made by the banks are however covered by this custom.

COMMISSIONER BROWN: It is the prime rate?

DR. HOLTROP: You might call it that. We don't use the notion of prime rate. All the rates are quite competitive, and in a way nobody knows whether the most favourable rate is that the bank will charge to the most favoured customer.

COMMISSIONER BROWN: Would you care to comment on the theory of a legislative ceiling on bank charges?

DR. HOLTROP: I must say that our experience with no legislative ceilings whatever has been favourable, and from what I have observed in the experience of other central banks and other banking systems I have tended to think that all these sorts of rules are dangerous in a way because you come

to points where the rule prevents you from doing the right thing.

It is all very nice to say that a certain rate of interest should not be exceeded either on the debit or the credit side at a certain moment, but nevertheless you can get into conditions, to take the example of the United Kingdom, that at a certain moment you really want to have strong influence, and you may have a bank rate of 7 per cent and the whole purpose of the bank rate is that it is charged to the customer. If it is not charged to the customer, you can't imagine that it has an influence on spending habits and under these circumstances -- which are exceptional, admittedly, -- you may say that it is perfectly all right if they have to pay 8 or 9 per cent on a bank loan, as it is the idea that this could reduce the demand for bank loans.

On the other hand, we have a competitive banking system, I must admit that, and there is complete freedom of action by the banks on high or low rates. We have no statutory limits as in the United States, for example, for credit interest which the bank pays. It is a highly competitive business and the banks can just pay for the deposits what they want. There is, of course, a certain tendency for all the normal depositors toget to a certain normal figure, but there again smaller banks will pay somewhat higher rates. Banks that are in a situation that they need more deposits will pay a somewhat higher rate than other banks, and we don't

by which means the [illegible] right hand.

It is all very nice to say that a certain rate of interest should not be exceeded either on the debit or the credit side at a certain moment, but nevertheless you can get into conditions, to take the example of the United Kingdom, that at a certain moment you really want to have strong influence, and you may have a bank rate of 7 per cent and the whole purpose of the bank rate is that it is charged to the customer. If it is not charged to the customer, you can't imagine that it has an influence on spending habits and under these circumstances -- which are exceptional, admittedly, -- you may say that it is perfectly all right if they have to pay 8 or 9 per cent on a bank loan, as it is the idea that this could reduce the demand for bank loans.

On the other hand, we have a competitive banking system, I must admit that, and there is complete freedom of action by the banks on high or low rates. We have no statutory limits as in the United States, for example, for credit interest which the bank pays. It is a highly competitive business and the banks can just pay for the deposits what they want. There is, of course, a certain tendency for all the normal depositors to get to a [illegible] will pay somewhat higher rates. Banks that are in [illegible] they need more deposits will pay a

find that that is disturbing at all. So, our experience with our freedom has been favourable, I would say.

COMMISSIONER BROWN: You increase bank rates and therefore there is an implication that all charges to customers are going to be increased. You also mentioned that it was very competitive. Does this apply in some cases where perhaps these increases don't go through?

DR. HOLTROP: They may not come through; we urge banks as much as possible to pass them on, so there is a tendency to ask the banks to let the bank rate work itself out. This is true also in the other cases when we reduce the rates; they are, however, free and we don't control them.

COMMISSIONER BROWN: How about other bank charges? That is, the banks charge you for other services?

DR. HOLTROP: Yes.

COMMISSIONER BROWN: Are these more or less standard or ---

DR. HOLTROP: There are certain banking charges where the banks have agreements among one another.

COMMISSIONER BROWN: And this is permitted?

DR. HOLTROP: Yes, this is permitted.

COMMISSIONER BROWN: There is one further question which I would like to ask on this, and this is one of our problems; what is the definition of a bank?

[illegible]

COMMISSIONER BROWN: You increase bank rates and therefore there is an implication that all charges to customers are going to be increased. You also mentioned that it was very competitive. Does this apply in some cases where perhaps these increases don't go through?

[illegible] we urge banks as much as possible to pass them on, so there is a tendency to ask the banks to let the bank rate work itself out. This is true also in the other cases when we reduce the rates; they are, however, free and we don't control them.

COMMISSIONER BROWN: How about other bank charges? That is, the banks charge you for other services?

DR. HOLTROP: Yes.

COMMISSIONER BROWN: Are these more or less standard or ---

DR. HOLTROP: There are certain banking charges where the banks have agreements among one another.

[illegible]

DR. HOLTROP: Yes, this is permitted.

COMMISSIONER BROWN: There is one further question which I would like to ask on this, and this is one of our problems: what is the definition of a

I understand you have such a definition by statute?

DR. HOLTROP: Yes, we have by statute, we have a definition and we call a bank every institution that makes it its business to receive, to a major extent, bank deposits and to make loans; that is our definition of a bank. Everybody who takes deposits and makes loans is a bank and comes under our control and is registered as a bank and is controlled by the central bank and comes under the whole legislation.

COMMISSIONER MACKINTOSH: How do you define to a major extent how much of a bank they have to be to be a bank?

DR. HOLTROP: You get to a fine point because we have a slightly different definition on the active side and on the passive side. Let us say that there are no statutory limits; it is left to the Netherlands bank to decide how it handles it and we do handle it this way. Taking the deposits, we have fixed -- a rather low quantitative limit; we say, I think it is, when you have 100,000 guilders on deposit that it is all right. On the other hand, in making loans, we look at the proportion to the other parts of their business. So, we say: if you are in the business of making loans as your normal type of business, then you are completely a bank.

If you take some small deposits or even accept that low limit of 100,000 guilders and only sometimes make a loan, but in the major part of your

[illegible]

DR. HOLTROP: [illegible]

[illegible] that makes it its business to receive, to a major extent, bank deposits and to make loans; that is our definition of a bank. Everybody who takes deposits and makes loans is a bank and comes under our control and is registered as a bank and is controlled by the central bank and comes under the [illegible] legislation.

COMMISSIONER MACKINTOSH: How do you define to a major extent how much of a bank they have to be to be a bank?

DR. HOLTROP: You get to a fine point because we have a slightly different definition on the active side and on the passive side. Let us say that there are no statutory limits; it is left to the Netherlands bank to decide how it handles it and we do handle it this way. Taking the deposits, we have fixed -- a rather low quantitative limit; we say, I think it is, when you have 100,000 guilders on deposit that it is all right. On the other hand, in making loans, we look at the proportion to the other parts of their business. So, we say: if you are in the business of making loans as your normal type of business, then you are completely a bank.

If you take some small deposits or even accept that low limit of 100,000 guilders and only sometimes make a loan, but in the major part of your

business you are not making loans, then we should say no, you are not a bank. This is a matter of judgment by the central bank.

COMMISSIONER MACKINTOSH: They must both make loans and deposits?

DR. HOLTROP: Yes.

COMMISSIONER MACKINTOSH: Then, in fact, you don't say that people, or institutions which have only a small amount on deposit, are not banks, but really you say they are too small for you to bring them into the system?

DR. HOLTROP: Yes, they are too small for us to register when you are below that limit and it is not worthwhile to be registered even if you act as a bank. Everybody can look in the registry to see if you are registered. Then, on the other hand, therefore we say if you take deposits and very exceptionally make a loan, we for that reason don't consider you a bank, but if you make it your business of making loans, then we do.

COMMISSIONER GIBSON: How do you define deposits, do you include time deposits?

DR. HOLTROP: Yes, we do. The difference between -- you get me into quite legalistic points here - you have, of course, to distinguish between (a) a private loan and (b) a deposit. But a deposit with us is a thing that either can be claimed back on demand or after a fixed time limit, and which is also publicly announced. You are willing to take

business you are not making loans, then we should say no, you are not a bank. This is a matter of judgment by the central bank.

COMMISSIONER MACKINTOSH: They must both make loans and deposits?

DR. HOLTROP: Yes.

COMMISSIONER MACKINTOSH: Then, in fact, you don't say that people, or institutions which have only a small amount on deposit, are not banks, but really you say they are too small for you to bring them into the system?

DR. HOLTROP: Yes, they are too small for us to register when you are below that limit and it is not worthwhile to be registered even if you act as a bank. Everybody can look in the registry to see if you are registered. Then, on the other hand, therefore we say if you take deposits and very exceptionally make a loan, we for that reason don't consider you a bank, but if you make it your business of making loans, then we do.

COMMISSIONER GIBSON: How do you define deposits, do you include time deposits?

DR. HOLTROP: Yes, we do. The difference between -- you get me into quite legalistic points here - you have, of course, to distinguish between (a) a private loan and (b) a deposit. But a deposit with us is a thing that either can be claimed back on demand or after a fixed time limit, and which is also publicly announced. You are willing to take

deposits, so it is also a question of public announcement. If you don't publicly announce you are willing to take deposits, but you get loans from some place where it could be a question of whether it is legally a loan or a deposit, then we will say this organization doesn't announce itself as taking deposits,and therefore is not a bank.

COMMISSIONER GIBSON: What if you are willing to sell fixed term paper?

DR. HOLTROP: Fixed term paper wouldn't be a deposit under our system, and institutions that sell fixed paper would not be considered to take deposits. I assume it might create problems if there were institutions of that kind, but there are not -- except the municipalities, you might say, but they again don't give loans. It is, I think, imaginary that you could try to sell paper on the money market and make loans on the other hand, but you would, if you did, according to our definition, not be a bank.

THE CHAIRMAN: I still fail to understand the real distinction between a deposit, when it is defined in the broad way you have defined it, and simply lending money to an institution for a fixed period. Suppose it is a time deposit to be withdrawn on two weeks' notice. What is the distinction from a monetary point of view between that and simply lending money to an institution for a fixed period?

DR. HOLTROP: I would say the distinction is in the public announcement. There is also the question of whether you are in the business of taking short term deposits from everybody, or whether you are in some sort of business which you finance partly by private loans from other people. That is a completely different situation, and from the monetary point of view I would say the man who does not publicly announce himself as taking deposits does not create that supposition of liquidity as does the man who takes a private loan.

If I make a private loan to some person I know very well that I am no longer liquid, because I have invested in his business. If, on the other hand, he has publicly announced that he takes deposits, and creates that expectation of being able to repay on demand, or to repay on the date named, without any doubt then he creates a public confidence which brings him into the monetary sphere, because he is then apt to get the liquid reserves of people temporarily into his custody. That is

THE CHAIRMAN: I still fail to understand the real distinction between a deposit, when it is defined in the broad way you have defined it, and simply lending money to an institution for a fixed period. Suppose it is a time deposit to be withdrawn on two weeks' notice. What is the distinction from a monetary point of view between that and simply lending money to an institution for a fixed period?

DR. HOLTROP: I would say the distinction is in the public announcement. There is also the question of whether you are in the business of taking shortterm deposits from everybody, or whether you are in some sort of business which you finance partly by private loans from other people. That is a completely different situation, and from the monetary point of view I would say the man who does not publicly announce himself as taking deposits does not create that supposition of liquidity as does the man who takes a private loan.

If I make a private loan to some person I know very well that I am no longer liquid, because I have invested in his business. If, on the other hand, he has publicly announced that he takes deposits, and creates that expectation of being able to repay on demand, or to repay on the date named, without any doubt then he creates a public confidence which brings him into the monetary sphere, because he is then apt to get the liquid reserves of people temporarily into his custody. That is

what I feel the difference is.

THE CHAIRMAN: It is in the extent to which he is in the business of accepting money on those terms?

DR. HOLTROP: Yes.

COMMISSIONER MACKINTOSH: Would you attach any importance to the question of whether the deposits were transferable by cheque?

DR. HOLTROP: No. I know it is one of the old definitions of money proper, of course, and I think in the Anglo-Saxon tradition this point has played a certain role because in the early times money was defined as consisting only of deposits subject to cheque. People have then just invented deposits not subject to cheque and have said that they are not money and should not be under control, and therefore, generally, in Anglo-Saxon countries that system has developed. Our tradition has never laid very much importance on that. Perhaps this is also because the cheque system has never been so developed in the European countries.

We have gone through different techniques, such as those employed in the giro system. The giro system has not been employed by the banks, but the central giro institutions have been government institutions. There is no doubt that they create money, of course. The difference between deposits subject to cheque and those not subject to cheque has never played an important role in the Continental tradition.

what I feel the difference is.

THE CHAIRMAN: It is in the extent to which he is in the business of accepting money on those terms?

DR. HOLTROP: Yes.

COMMISSIONER MACKINTOSH: Would you attach any importance to the question of whether the deposits were transferable by cheque?

DR. HOLTROP: No. I know it is one of the old definitions of money proper, of course, and I think in the Anglo-Saxon tradition this point has played a certain role because in the early times money was defined as consisting only of deposits subject to cheque. People have then just invented deposits not subject to cheque and have said that they are not money and should not be under control, and therefore, generally, in Anglo-Saxon countries that system has developed. Our tradition has [illegible] is also because the cheque system has never been so developed in the European countries.

We have gone through different techniques, such as those employed in the giro system. The giro system has not been employed by the banks, but the central giro institutions have been government institutions. There is no doubt that they create money, of course. The difference between deposits subject to cheque and those not subject to cheque has never played an important role in the Continental

THE CHAIRMAN: Is it one of the conditions of a bank that it must be open to accept deposits from any person who wishes to make them? Suppose an institution acted in a more restricted way and dealt with only a group of people who were, in some way, members of the institution; suppose it was not doing business with the general public. Would you consider that institution a bank, or have you not encountered that sort of situation?

DR. HOLTROP: I do not know that I would be able to draw on examples. The limitation of membership would certainly not exempt them. We have the co-operative credit banks which do not limit their business to their members, but if they did limit their business to their members we would not consider them an exception, because if everybody could become a member then they would be dealing with the general public.

I could imagine a concern being a kind of co-operative which does business only within the limits of that concern. It might take deposits of concern-companies only. In that case the question might come up as to whether it is a bank or not, as a matter of definition. If it says: "No, we do not take deposits from anybody else; we take them from members of our own family only", then the question would indeed be whether it is a public deposit or not, or whether it is really a loan.

THE CHAIRMAN: Have you credit unions in the Netherlands?

THE CHAIRMAN: Is it one of the conditions of a bank that it must be open to accept deposits from any person who wishes to make them? Suppose an institution acted in a more restricted way and dealt with only a group of people who were, in some way, members of the institution; suppose it was not doing business with the general public. Would you consider that institution a bank, or have you not encountered that sort of situation?

DR. HOLTROP: I do not know that I would be able to draw on examples. The limitation of membership would certainly not exempt them. We have the co-operative credit banks which do not limit their business to their members, but if they did limit their business to their members we would not consider them an exception, because if everybody could become a member then they would be dealing with the general public.

I could imagine a concern being a kind of co-operative which does business only within the limits of that concern. It might take deposits of concern-companies only. In that case the question might come up as to whether it is a bank or not, as a matter of definition. If it says: "No, we do not take deposits from anybody else; we take them from members of our own family only", then the question would indeed be whether it is a public deposit or not, or whether it is really a loan.

THE CHAIRMAN: Have you credit unions

DR. HOLTROP: Not what you call a credit union.

THE CHAIRMAN: You understand our system of credit unions, do you?

DR. HOLTROP: Yes, I understand credit unions. That is a kind of membership system in which the members make deposits and obtain the right to qualify for loans as members. We do not know that system.

THE CHAIRMAN: You have what are known as co-operative banks?

DR. HOLTROP: We have a very important co-operative agricultural banking system.

THE CHAIRMAN: Those are agricultural banks?

DR. HOLTROP: Yes, but as a matter of fact, they are more -- it is not exclusively agricultural. In as much as the agricultural communities have gradually developed industrial activities, et cetera, these are also taken care of by this banking system.

THE CHAIRMAN: You have what you call agricultural credit banks?

DR. HOLTROP: Yes, they call themselves agricultural credit banks.

THE CHAIRMAN: What sort of business do they do?

DR. HOLTROP: They do the same kind of business as commercial banks with this difference, that they have far earlier developed a system of savings deposits. As a consequence they are great

receivers of savings deposits, and they have, therefore, different traditions of investment. While our commercial banks have more or less followed the English tradition of liquid banking -- short term banking -- the agricultural credit banks have followed more the tradition of long term financing because on the basis of their savings deposits they have always considered themselves in a position to do so. They will invest in mortgages and in long term bonds in the capital market to a large extent. Their savings deposits will be very much higher than the total of their time and current deposits or slight deposits. They do have a different type of business.

THE CHAIRMAN: But it is all part of the banking business?

DR. HOLTROP: Yes, it is all part of the banking business, and it is all controlled, but in the application of rules we distinguish between the two parts of their business.

THE CHAIRMAN: And they do business with the public generally, whether they are farmers or not?

DR. HOLTROP: They do business with the local public generally.

THE CHAIRMAN: They are designed especially to service the agricultural interests?

DR. HOLTROP: Yes, as co-operatives their main aim is to serve the agricultural community. They are based on the Raiffeisen system.

[illegible] different traditions of investment. While our commercial banks have more or less followed the English tradition of liquid banking -- short term lending -- the agricultural credit banks have followed more the tradition of long term financing because on the basis of their savings deposits they have always considered themselves in a position to do so. They will invest in mortgages and in long term bonds in the capital market to a large extent. Their savings deposits will be very much higher than the total of their time and current deposits or sight deposits. They do have a different type of business.

THE CHAIRMAN: But it is all part of the banking business?

DR. HOLTROP: Yes, it is all part of the banking business, and it is all controlled, but in the application of rules we distinguish between the two parts of their business.

THE CHAIRMAN: And they do business with the public generally, whether they are farmers or not?

DR. HOLTROP: They do business with the local public generally.

THE CHAIRMAN: They are designed especially to service the agricultural industry?

DR. HOLTROP: Yes, as co-operatives.

THE CHAIRMAN: They are co-operatives in what sense?

DR. HOLTROP: They are co-operatives in the sense that they have members, and the members are liable for the obligations of the bank, so part of their capital will not be paid in but will consist of the liability of the members.

THE CHAIRMAN: But the business at the bank is not confined to its members? The public generally can use the agricultural credit bank?

DR. HOLTROP: I think there are shades of difference locally. You must realize that this is a very pervasive system, and that there are at least some 1,300 member banks each of which is a legally separate unit. They are members of two big systems. Their local rules might be slightly different, but as a matter of principle they are in the general banking business, and the local carpenter or blacksmith is just as welcome, and the small scale industry is just as welcome, as a client, as the farmer. However, that may vary from bank to bank because the strength of the system is the co-operative responsibility. The committee of farmers which controls the giving of the loans knows everybody and knows everybody's credit standing in that small community.

COMMISSIONER BROWN: How are their reserves handled? Are they separate banks or are they part of a branch system?

[illegible]

DR. HOLTROP: They are co-operatives in the sense that they have members, and the members are liable for the obligations of the bank, so part of their capital will not be paid in but will consist of the liability of the members.

THE CHAIRMAN: But the business of the bank is not confined to its members? The public generally can use the agricultural credit bank?

DR. HOLTROP. I think there are shades of difference locally. You must realize that this is a very pervasive system, and that there are at least some 1,300 member banks each of which is a legally separate unit. They are members of two big systems. Their local rules might be slightly different, but as a matter of principle they are in the general banking business, and the local carpenter or blacksmith is just as welcome, and the small scale industry is just as welcome, as a client, as the farmer. However, that may vary from bank to bank because the strength of the system is the co-operative responsibility. The committee of farmers which controls the giving of the loans knows everybody and knows everybody's credit standing in [illegible]

[illegible]

reserves handled? Are they separate banks or are [illegible]

DR. HOLTROP: They are again members of a central system. There are two big central systems and practically all of these credit banks are members of one system or the other, and they will keep their surplus reserves in the central bank.

COMMISSIONER BROWN: And it is the central bank of the system that you look at?

DR. HOLTROP: Yes, it is the central bank that we look at. Fundamentally, we are responsible for the control of the whole system, but we exercise this control through the intermediary of the central bank.

COMMISSIONER BROWN: And it is the consolidated picture that you look at?

DR. HOLTROP: We look at the consolidated picture, yes, and they look at the individual banks. They take care of the individual units.

COMMISSIONER MacKEEN: Have you any institutions that are comparable to our savings and loan companies which specialize mainly in mortgages and which have no membership?

DR. HOLTROP: No, our mortgage banks -- we have a mortgage bank system but it is completely different from yours because it is a professional system of capital market institutions that sell a special type of bond which has a special name.

They work on a rather narrow margin. The difference may be 3/4 of one per cent. They will borrow money on the long term capital market, and they will give mortgages.

DR. HOLTROP: [illegible]

a central system. There are two big central b[illegible]

[illegible]

of one system or the other, and they will keep their

surplus reserves in the central bank.

COMMISSIONER BROWN: And it is the

central bank of the system that you look at?

DR. HOLTROP: Yes, it is the central

bank that we look at. Fundamentally, we are responsible

for the control of the whole system, but we exercise

this control through the intermediary of the central

bank.

COMMISSIONER BROWN: And it is the

consolidated picture that you look at?

DR. HOLTROP: We look at the consolidated

picture, yes, and they look at the individual banks.

[illegible]

COMMISSIONER McCLEAN: Have you any

institutions that are comparable to our savings

and loan companies which specialize mainly in mortgages

and which have no membership?

DR. HOLTROP: No, our mortgage banks --

we have a mortgage bank system but it is completely

different from yours because it is a professional

system of capital market institutions that sell a

special type of bond which has a special name.

They work on a

rather narrow margin. The difference may be 3/4

of one per cent. They will borrow money on the

COMMISSIONER MacKEEN: Do they accept deposits?

DR. HOLTROP: No, they do not accept deposits. If they did they would, of course, come under our control.

COMMISSIONER MacKEEN: Tney do not come under your control?

DR. HOLTROP: No, they are what we call completely capital market institutions handling only long-term loans. In case you are wondering where the farmer gets his mortgages I should say that the agricultural credit banks also do give mortgage loans.

COMMISSIONER MacKEEN: But suppose someone in the city wants to borrow on a residence, or something of that sort?

DR. HOLTROP: Again, the answer is that house ownership is not as widespread in our country as it is in yours because it does not have the same tax advantages as it has in this country and in America. Therefore, the proportion of private house ownership financed by mortgage in Holland is smaller than in your country. If a person wants a mortgage he would have to turn to the mortgage banks or he would turn to what we call a notary. A notary in Holland is in a different position from that of a notary public in the United States. In Holland he is a man who may manage trust funds and may place part of them in mortgages, and that is also a local business. He may thus act as an in-between in placing mortgages. So, there

[illegible]

DR. HOLTROP: No, they are what we call [illegible] where the farmer gets his mortgages I should say that the agricultural credit banks also do give mortgage loans.

[illegible] in the city wants to borrow on a residence, or something of that sort?

DR. HOLTROP: Again the answer is that house ownership is not as widespread in our country as it is in yours because it does not have the same tax advantages as it has in this country and in America. Therefore, the proportion of private house ownership financed by mortgage in Holland is smaller than in your country. If a person wants a mortgage he would have to turn to the mortgage banks or he would turn to what we call a notary. A notary in Holland is in a different position from that of a notary public in the United States. In Holland he is a man who may receive trust funds and may [illegible]t of them in mortgages, and that is [illegible] He may thus act as [illegible]

is a private market for mortgages in that way. Have I made myself clear?

COMMISSIONER LEMAN: From where does this notary get his money? Does he take deposits from clients?

DR. HOLTROP: No, he will be only a middle-man. He will be the man who takes care of the administration of properties, and in that business of administration he will be asked to place some money on a mortgage. He will take care of that. He acts as a trustee, and as a trustee he may be a local middle-man in placing mortgage money also.

COMMISSIONER MacKEEN: Have you trust companies such as we have?

DR. HOLTROP: We do have them, but they are much less developed than on the American continent.

COMMISSIONER MacKEEN: Would they accept deposits and take back mortgages?

DR. HOLTROP: No, because if they take deposits that will make them banks.

COMMISSIONER GIBSON: Going back to the 100 per cent deposit scheme for extra deposits which you put to the banks in January, do you say it is a little early to judge how well it has worked? Would you care to comment a little more on that? How do the banks react to it?

DR. HOLTROP: We have now this tradition of discussing with the banks monetary policy over this whole period of after-the-war development of

COMMISSIONER LEMAN: From where does this notary get his money? Does he take deposits from clients?

DR. HOLTROP: No, he will be only a middle-man. He will be the man who takes care of the administration of properties, and in that business of administration he will be asked to place some money on a mortgage. He will take care of that. He acts as a trustee, and as a trustee he may be a local middle-man in placing mortgage money also.

COMMISSIONER McKEEN: Have you trust companies such as we have?

DR. HOLTROP: We do have them, but they are much less developed than on the American continent.

COMMISSIONER McKEEN: Would they accept deposits and take back mortgages?

DR. HOLTROP: No, because if they take deposits that will make them banks.

COMMISSIONER OLSON: Going back to the 100 per cent deposit scheme for extra deposits which you put to the banks in January, do you say it is a little early to judge how well it has worked? Would you care to comment a little more on that? How do the banks react to it?

DR. HOLTROP: We have now this tradition of discussing with the banks monetary policy over this whole period of after-the-war development of

fifteen years. We have gone through all sorts of ups and downs, and we have found the banks willing to accept basically the thesis that there ought to be monetary policy in the country and that it must be the central bank which makes the monetary policy. In so far as the banking community is concerned, I would say that there is that basic acceptance of the existence of monetary policy, and that the consequence of monetary policy is that it should limit the banks in their activity.

On the basis of the acceptance of that thesis, we have found it possible in that time to agree with the banks on certain policies.

These policies have been different because the situations under which we have lived have been different. The legal powers of the bank have been gradually changed. We had the first act of credit control in 1948. I have mentioned it here, and I think that date is correct. The second one was in 1954, and I think the first one was in 1948. The second act has been worked out in rather strong co-operation with the banks. It was then recognized that the existing act was not satisfactory, and the minister of finance asked us to work out a new act, and we consulted the banks very closely in this field. The background of it is that after all we have a system to which the banks have fundamentally agreed. They have agreed to let it work. Nevertheless, under this system they will try to be as free

fifteen years. We have gone through all sorts of ups and downs, and we have found the banks willing to accept basically the thesis that there ought to be monetary policy in the country and that it must be the central bank which makes the monetary policy. In so far as the banking community is concerned, I would say that there is that basic acceptance of the existence of monetary policy, and that the consequence of monetary policy is that it should limit the banks in their activity.

On the basis of the acceptance of that thesis, we have found it possible in that time to agree with the banks on certain policies.

These policies have been different because the situations under which we have lived have been different. The legal powers of the bank have been gradually changed. We had the first act of credit control in 1948. I have mentioned it here, and I think that date is correct. The second one was in 1954, and I think the first one was in 1948. The second act has been worked out in rather strong co-operation with the banks. It was then recognized that the existing act was not satisfactory, and the minister of finance asked us to work out a new act, and we consulted the banks very closely in this field. The background of it is that after all we have a system to which the banks have fundamentally agreed. They have agreed to let it work. Therefore under this system they will try to be as free

as possible, as, of course, they have their interests which may be contrary to those of the central bank as a result we may have some difficulties from time to time in agreeing about the exact measures that should be taken, and we may have differences about the timing of the measures.

Since the new act has been in existence we have had only two periods in which we, on our side, thought it necessary that there should be restrictive monetary policy. One period was 1956-57, and the other is this present period of 1961-62. There was no fundamental disagreement with the banks at all about the desirability of exercising a certain restrictive influence and there was, therefore, the possibility of agreeing basically upon how we should do it. We have agreed with the banks upon how to do it, and whether it is satisfactory or not in these things you have to agree on certain definitions. The types of loans that are limited under the system are the short-term loans. They are the current account loans. They are not the long-term loans that are supposed to come out of the long-term money.

We have to make that separation also with respect to the agricultural credit banks. The normal increase in their savings deposits, in our opinion, do not create any monetary problem. We consider those as normal capital market resources, on which they can base their long-term loans.

[illegible]

which may be contrary to those of the central bank as a result we may have some difficulties from time to time in agreeing about the exact measures that should be taken, and we may have differences about the timing of the measures.

Since the new act has been in existence we have had only two periods in which we, on our side, thought it necessary that there should be restrictive monetary policy. One period was 1956-57, and the other is this present period of 1961-62. There was no fundamental disagreement with the banks at all about the desirability of exercising a certain restrictive [illegible] of agreeing basically upon how we should do it. We have agreed with the banks upon how to do it, and whether it is satisfactory or not in these things you have to agree on certain definitives. The types of loans that are limited under the system are the short-term loans. They are the current account items. They are not the long-term loans that are supposed to come out of the long term money.

We have to make that separation also with respect to the agricultural credit banks. The normal increase in their savings deposits, in our opinion, do not create any monetary problem. We consider those as normal capital market resources on which they can base their long term loans.

We have tried to introduce this same notion in the commercial banking system where the development of the savings deposits is a new development. But in that respect I would say that the situation is not quite clarified, because we find that there are some differences of opinion, or shades of opinion, about the exact charzcter of the savings deposits which these banks get. There is a difference of opinion as to whether they are real savings deposits or whether they are not.

The velocity of turnover of the savings deposits of the commercial banks is comparatively higher at the present moment, for example, than the other savings deposits. So there we are still feeling our way. We are also, therefore, still feeling our way in the volume of long-term credit the banks should be allowed to give. Allowing for those problems of adaptation of the system to the long run conditions in the future, we feel -- and the banks confirm this -- that the restrictive influence we exert is of importance. One of the important things is, I do believe, that the aim of monetary policy is to have an influence on total spending. That you should always keep in mind. If you have no influence on total spending the only thing is to influence by the rate of interest, short-term capital movement internationally. But that is not the fundamental monetary problem. That is solving your balance of payment problem on the short-term basis. The real object of monetary policy should be to influence the total expenditure. The possibilities of doing that in the purely private field are limited. They are more limited than they were in the olden times. In the world of before 1914, when short-term government credit was not known and so-called liquidity had the form of short-term loans to the business community a tight market meant, indeed, the withdrawal of loans from the market and made a direct deflationary influence. This is not true at the present moment because a tight market at the present moment, in the first instance, squeezes

The velocity of turnover of the savings deposits is of [illegible] present moment, for example, than the other savings [illegible] are also, therefore, still feeling our way in the volume of long-term credit the banks should be allowed to give. Allowing for those problems of adaptation of the system to the long run conditions in the future, we feel -- and the banks confirm this -- that the restrictive influence we exert is of importance. One of the important things is, I do believe, that the aim of monetary policy is to have an influence on total spending. That you should always keep in mind. If you have no influence on total spending the only thing is to influence by the rate of interest, short-term capital movement internationally. But that is not the fundamental monetary problem. That is solving your balance of payment problem on the short-term basis. The real object of monetary policy should be to influence the total expenditure. The possibilities of doing that in the purely private field are limited. They are more limited than they were in the olden times: In the world of before 1914, when short-term government credit was not known and so-called liquidity had the form of short-term loans to the business community a tight market meant, indeed, the withdrawal of loans [illegible] This is not true at the present moment because a tight market at the present moment, in the first instance,

more the government, or would squeeze the government more than it would squeeze the private sector of the economy. In so far as it squeezes the government we try to escape from these consequences. We then consider the monetary policy of the government as a separate item. That is a government decision. You do not try to influence the monetary policy of the government by the action of central banks with respect to the banking system. The actions of the central bank, through the banking system, has the purpose of influencing either the expenditures of the business community or the ways of financing by the business community. The ways of financing of the business community are now such that when the restrictive policy is in its first stages it will force the business community to look for long-term money instead of financing itself by the banking community. When we tell the banks it is time they should restrict their credit more, we also tell them it is time they investigate what clients they might send to the capital market to finance themselves by long-term borrowing. If he is big enough he should do this by public borrowing, or if he is smaller, by borrowing from a life insurance company or other institution that lends long-term money. The ultimate effect on total expenditure will be gradual because therefrom there will first be an influence on the long-term market, and the relationship of demand and supply in the long-term market will be affected. The business community that finances itself in the long-term market will find it will get tighter and will adapt its plans because the financing opportunities are getting

more the government, or would squeeze the government more than it would squeeze the private sector of the economy. In so far as it squeezes the government we try to escape from these consequences. We then consider the monetary policy of the government as a separate item. That is a government decision. You do not try to influence the monetary policy of the government by the action of central banks with respect to the banking system. The actions of the central bank, through the banking system, has the purpose of influencing either the expenditures of the business community or the ways of financing by the business community. The ways of financing of the business community are now such that when the restrictive policy is in its first stages it will force the business community to look for long-term money instead of financing itself by the banking community. When we tell the banks it is time they should restrict their credit more, we also tell them it is time they investigate what clients they might send to the capital market to finance themselves by long-term borrowing. If he is big enough he should do this by public borrowing, or if he is smaller, by borrowing from a life insurance company or other [illegible] effect on total expenditure will be gradual because therefrom there will first be an influence on the long-term market, and the relationship of demand and supply in the long-term market will be affected. The business community that finances itself in the long-term market will find it will get tighter and will start [illegible] [illegible] cause the financing opportunities are getting

restricted.

My philosophy is really that I do believe the business community fundamentally is more influenced in its spending habits by its expectation of being able to get financed than by the actual rate of interest. I do know of the examples of house building and public utility investment where whether the rate is four or five % is, of course, of great importance. But in industry my own experience as an industrialist was not that we ever wondered so much whether the rate would be four or four and a half, but whether one would be able to get the money. That was the important point. Therefore, when you ask how, for example, in 1956-57, our credit restrictions have worked out, definitely we have forced the bank to shove off part of the market to the capital market, and the capital market became tight and many entrepreneurs said, "My God, I cannot go on with my present expansion plan because I cannot find the money." Of course, that will then influence their investment decisions; and at that moment that is the purpose of the whole policy, that at a certain moment the investment decisions of the business community have to be restricted because they happen to exceed the amount of current savings. You cannot replace that difference between current saving and current investment by creating money without getting into all the inflationary consequences of the creation of money. So part of the whole thing is the exertion of the restrictive influence on the banking system, and the banking system pushing off that restrictive

influence either by being less easy in taking on new customers for borrowing or by pushing them off to the capital market; the capital market then getting tighter, and then, as a consequence, entrepreneurs changing to adapting their investment decisions. This is in the period of boom in which I think monetary policy, in the restricted sense of central bank policy, has the most possibilities of success.

Far more difficult is monetary policy in the sense of central bank policy in times of recession, because the characteristic of a recession is that entrepreneurs will not invest whatever the rate of interest is. Then you have the simile of the horse: you can lead him to the pool, but you cannot force him to drink. There the central bank policy, under those circumstances, cannot easily have an independent influence. It is under those circumstances, especially, that government monetary policy ought to play a role. There, you note from my exposition, that I think from the point of view of logic we must think of these government policies as being part of monetary policy. Those parts of government policy that are concerned with financing budgetary deficits by long-term borrowing or by short-term borrowing or by borrowing from the banking system or with creating even surpluses, are indeed cases of pure monetary policy in the general sense. It is exactly the same thing again: it is again exerting an influence on the total amount of expenditures. Under present conditions the influence of government in that field can be enormous and far more direct than the influence of the central bank. There is no doubt about

influence either by being less easy in taking on new customers for borrowing or by pushing them off to the capital market; the capital market then getting tighter, and then, as a consequence, entrepreneurs changing to adapting their investment decisions. This is in the period of boom in which I think monetary policy, in the restricted sense of central bank policy, has the most possibilities of success.

Far more difficult is monetary policy in the sense of central bank policy in times of recession, because the characteristic of a recession is that entrepreneurs will not invest whatever the rate of interest is. Then you have the simile of the horse: you can lead him to the pool, but you cannot force him to drink. There the central bank policy, under those circumstances, cannot easily have an independent influence. It is under those circumstances, especially, that government monetary policy ought to play a role. There you note from my exposition that I think from the point of view of logic we must think of these government policies as being part of monetary policy. Those parts of government policy that are concerned with financing budgetary deficits by long-term borrowing or by short-term borrowing or by borrowing from the banking system or with creating even surplses, are indeed cases of pure monetary policy in the general sense.

It is exactly the same thing again: it is again exerting an influence on the total amount of expenditures. Under present conditions the influence of government in that field can be enormous and far more direct than the influence of the central bank. There is no doubt about

that. If the policy of the government is contrary to the one of the central bank it is , of course, then very difficult for the central bank to compensate for what government policy might be doing. That is, increasing expenditure in a period when it should be reduced, or the reverse, reducing expenditure in a period when it should be increased.

COMMISSIONER GIBSON: Dr. Holtrop, would you care to say a word on the particular advantage of this system of restriction as compared to other systems, such as setting particular ratios?

DR. HOLTROP: I would not pretend there are particular advantages. The purpose of the exercise is that bank credit, the expansion of bank credit, should be restrained under certain circumstances. If you can use other techniques, because your market is sensitive to other techniques, then use them. This technique of ours, which we have to use because others would not work, is a rather daring technique. I do not pretend it is easy to say, in my wisdom, that bank loans in a year may be increased by eight and not by six or ten. As a matter of fact, only a week ago I was discussing the subject with the banks, and we agreed we would prolong the half per cent for two months and then add two months of one per cent, because we admitted we came into the period of heavy seasonal demand and that we should take that into consideration. Now we have a total of ten months of half per cent and two months of one per cent, and the total increase over the year would therefore be 7 per cent, but they had a leeway at the

[illegible]

the one of the [illegible]

very difficult [illegible]

what government policy might be doing.

That is, increasing expenditure in a period when it should be reduced, or the reverse, reducing expenditure in a period when it should be increased.

COMMISSIONER GIBSON: Dr. Holtrop, would you care to say a word on the particular advantage of this system of restriction as compared to other systems, such as setting particular ratios?

DR. HOLTROP: I would not pretend there are particular advantages. The purpose of the exercise is that bank credit, the expansion of bank credit, should be restrained under certain circumstances. If you can use other techniques, because your market is sensitive to other techniques, then use them. This technique of ours, which we have to use because others would not work, is a rather daring technique. I do not pretend it is easy to say, in my wisdom, that bank loans in a year may be increased by eight and not by six or ten. As a matter of fact, only a week ago I was discussing the subject with the banks, and we agreed we would prolong the half per cent for two months and then add two months of one per cent, because we admitted we came into the period of heavy seasonal demand and that we should take that into consideration. Now we have a total of ten months of half per cent and two months of one per cent, and the total increase over the year would therefore be 7 per cent, but they had a leeway at the

beginning of the year of 1½ per cent; and it all comes out that the admissible increase for this year would be 8½ per cent. This is not arithmetical, but it is tentative. However, there is some thorough thinking behind it. I can rationalize these figures, but I do not pretend it is algebra to figure it out. The banks talk about their own business and they know under what tensions they are, and they react to this kind of thinking, and they say, "It is impossible the demand on credit is so great we could not restrict it to the figures you mentioned," or they react as people who feel they can live up to those conditions.

Personally, I take the position-- and it is an important attitude, of course --, that I consider it impossible for central bank policy to be restrictive in the sense you force a reduction of credit upon the private sector of the economy in a boom. I could imagine people telling me, "Why do you allow any increase in credit at all at the present moment? You should reduce credit." My answer is that the economy does not work that way. It is impossible in a boom to reduce credit; or, otherwise, you break the system and create a crisis. But you can restrict it, and you should, under those conditions.

COMMISSIONER BROWN: This increase of half a per cent per month is for individual banks?

DR. HOLTROP: Yes, and also for the collectivity.

COMMISSIONER BROWN: Does not this also mean that in a boom period, where there is pressure for additional credit, it ensures all the banks increase at

beginning of the year of 1½ per cent; and it all comes out that the admissible increase for this year would be 8½ per cent. This is not arithmetical, but it is tentative. However, there is some thorough thinking behind it. I can rationalize these figures, but I do not pretend it is algebra to figure it out. The banks talk about their own business and they know under what reactions they are, and they react to this kind of thinking, and they say, "It is impossible the demand on credit is so great we could not restrict it to the figures you mentioned." or they react as people who feel they can live up to those conditions.

Personally, I take the position -- and it is an important attitude, of course --, that I consider it impossible for central bank policy to be restrictive in the sense you force a reduction of credit upon the private sector of the economy in a boom. I could imagine people telling me, "Why do you allow any increase in credit at all at the present moment? You should reduce credit." My answer is that the economy does not work that way. It is impossible in a boom to reduce credit; or, otherwise, you break the system and create a crisis. But you can restrict it, and you should [illegible].

COMMISSIONER BROWN: This increase of half a per cent per month is for individual banks?

DR. HOLTROP: Yes, and also for the collectivity.

COMMISSIONER BROWN: Does not this also mean that in a boom period, where there is pressure for additional credit, it ensures all the banks increase a

the same rate, and to that extent reduces competition?

DR. HOLTROP: Yes, it tends to, but there are, of course, banks who are in excess of and banks who are not in excess of this figure. But you are right. That creates even some tensions because the banking community will tell you it is not fair that certain banks, which at this moment or in the last few years, have been growing faster than other banks should be subject to the same restrictions, and that you should take that into consideration. There my answer has always been that I admit it is perfectly fair for some banks to grow faster than other banks in periods of normalcy, but in that short period it is necessary to have credit restrictions they should stop to grow faster. It is impossible to take that into consideration. You cannot assign a certain percentage of growth to one bank which you do not give to other banks. But it is true that this system is one meant for only a relatively short period. You cannot go on for years and tell the banks, "You can only increase your loans so much as compared with a certain period, at a basic percentage." Then in a period of relaxation you have to say, "We need not have controls presently."

COMMISSIONER BROWN: That is, you re-establish your competitive position?

DR. HOLTROP: Yes.

COMMISSIONER BROWN: You mentioned you had come to an agreement about allowing an increase of one per cent bank rate for two months, based on seasonal demand?

DR. HOLTROP: Yes.

the same rate, and to that extent reduces competition?

DR. HOLTROP: Yes, it tends to, but there are, of course, banks who are in excess of and banks who are not in excess of this figure. But you are right. That [illegible] will tell you it is not fair that certain banks, which this moment or in the last few years, have been growing faster than other banks should be subject to the same restrictions, and that you should take that into consideration. There my answer has always been that I admit it is perfectly fair for some banks to grow faster than other banks in periods of normalcy, but in that short period it is necessary to have credit restrictions they should stop to grow faster. It is impossible to take that into consideration. You cannot assign a certain percentage of growth to one bank which you do not give to other banks. But it is true that this system is one meant for only a relatively short period. You cannot go on for years and tell the banks, "You can only increase your loans so much as compared with a certain period, at a basic percentage." Then in a period of relaxation you have to say, "We need not have controls presently."

COMMISSIONER BROWN: That is, you re-establish your competitive position?

DR. HOLTROP: Yes.

COMMISSIONER BROWN: You mentioned you had come to an agreement about allowing an increase of one per cent bank rate for two months, based on seasonal demand

DR. HOLTROP: Yes.

COMMISSIONER BROWN: Is there any thought of soaking up this extra seasonal increase in the following two months after that?

DR. HOLTROP: I would have to put it this way, if I fully took the season as far as our experience goes into consideration, I even know, and they know also, that the amount of expansion we allow them at the present moment is really too low, even taking the one per cent into consideration, because this is the tax season and the demand for loans will be big. But in the four months from May to August we allowed them a half a per cent increase. Now we know that, seasonally, they should not have increased at all, and they have not. But, as a consequence they have got some leeway because of the slack season in the past four months.

COMMISSIONER LEMAN: Is it cumulative?

DR. HOLTROP: Yes, it is cumulative for the separate banks and the system as a whole. The punitive conditions of having to make deposits with the central bank only apply when current activity of the banks is in excess of the requirement. At the moment, when the collectivity is all right, individual banks do not have to make deposits with us.

COMMISSIONER BROWN: Is there any transfer of central bank funds between banks?

DR. HOLTROP: That would not help them. There is, because through the call market they can transfer any amount of money between themselves.

COMMISSIONER BROWN: But there is no direct trading of what is referred to as federal funds?

DR. HOLTROP: No, because the notion of

[illegible]

[illegible] up this extra seasonal increase in the following two months after that?

DR. HOLTROP: I would have to put it this way, if I fully took the season as far as our experience goes into consideration, I even know, and they know also that the amount of expansion we allow them at the present moment is really too low even taking the one per cent into consideration, because this is the tax season and the demand for loans will be big. But in the four months from May to August we allowed them a half a per cent increase. Now we know that, seasonally, they should not have increased at all, and they have not. But, as a consequence they have got some leeway because of the slack season in the past four months.

[illegible]

DR. HOLTROP: Yes, it is cumulative for the separate banks and the system as a whole. The punitive conditions of having to make deposits with the central bank only apply when current activity of the banks is in excess of the requirement. At the moment, when the collectivity is all right, individual banks do not have to make deposits with us.

COMMISSIONER BROWN: Is there any transfer of [illegible]

DR. HOLTROP: That would not help them. There is, because through the call market they can transfer any amount of money between themselves.

[illegible] BROWN: But there is no direct trading of what is referred to as federal funds?

federal funds does not exist in our market. There is the call market, and that is available for ready money on a daily basis, where the banks can exchange their surpluses and deficits.

COMMISSIONER MACKINTOSH: When you say you consult the banks and discuss things with them, how many banks have you in mind?

DR. HOLTROP: I think the number of registered banks is more than 100 -- something like 120 -- but that includes all kinds of small institutions. We talk ourselves about the representative banks, which we think are important, and they are 36 in number. They are also included in our monthly published statistics, and the smaller banks'are not published monthly by us.

The banks speak to us through their representative organization, The Bankers' Association, of which all the banks are a member. It is the board of the Bankers' Association which is the body with which we discuss these things and make agreements. At a certain moment they may want to consult their general assembly, to hear whether there are still difficulties.

COMMISSIONER GIBSON: Are not there the Big Four which do a high proportion of the total business?

DR. HOLTROP: Yes, there are the Big Four which do a large proportion -- between 60 and 70 per cent -- of the business.

COMMISSIONER LEMAN: There is a sentence in your memorandum, Dr. Holtrop, that puzzles me a bit. Perhaps you have answered it this morning, because you have covered so much ground, but I didn't quite get the sense of the answer. It is on page 9:

> "It is monetary policy alone, that is interested in the level of income and expenditure only, and not in its competition."

You have just been dwelling on this, and said that the job of monetary policy is to influence total expenditure. Then you go on and say:

> "This is, no doubt, the reason why, to such a large extent, the management of monetary policy can be delegated to a non-political authority; the central bank."

Do you feel these monetary actions are quite neutral in their incidence?

DR. HOLTROP: 100 per cent neutrality would not exist, no, I don't think. After all, by monetary action you can only act on the expenditure of those people who are dependent upon credit, or directly upon those who are dependent on short-term credit. You could not influence the spending of the rest of the community. However, I do not consider that as a great inequity. It is natural that those who have the advantage of being able to make use of short-term credit should also be the ones who are influenced by the necessity of restricting the creation of short-term credit. There is, of course, that

COMMISSIONER LEMAN: There is a sentence in your memorandum, Dr. Holtrop, that puzzles me a bit. Perhaps you have answered it this morning, because you have covered so much ground, but I didn't quite get the sense of the answer. It is on page 9:

"It is monetary policy alone, that is interested in the level of income and expenditure only, and not in its competition."

You have just been dwelling on this, and said that the job of monetary policy is to influence total expenditure. Then you go on and say:

"This is, no doubt, the reason why, to such a large extent, the management of monetary policy can be delegated to a non-political authority; the central bank."

Do you feel these monetary actions are quite neutral in their incidence?

DR. HOLTROP: 100 per cent neutrality would not exist, no, I don't think. After all, by monetary action you can only act on the expenditure of those people who are dependent upon credit, or directly upon those who are dependent on short-term credit. You could not influence the spending of the rest of the community. However, I do not consider that as a great inequity. It is natural that those who have the advantage of being able to make use of short-term credit should also be the ones who are influenced by the [illegible] of [illegible] creation of short-term credit. There is, of course, the

general question, the question which is often discussed as to how far credit restrictive measures do or do not have more influence on the small man than on the big industries. It is not a subject that in our country has ever played an important role.

To answer your question, there is some lack of complete neutrality; that does not exist. However, on the other hand, it is neutral in so far as it is left to the choice of the banking system and the fully competitive system of short-term credit to pass on the pressure of a restrictive measure to the community. I think it would bring monetary policy into completely other problems if you would say, for example, that one of the specific purposes of monetary policy ought to be to stimulate growth. Then you would ask, "How do I stimulate growth?" You might say, "I want to grow in the automotive industry" -- or in some other industry. "I want to stimulate investment in certain directions." If that were the way you would want to apply monetary policy you would be completely out of the neutral sphere, and would come into a sphere where it would be inconceivable the decisions could be left to a completely non-political institution like the central bank.

That is what I mean in this sentence. Now it must be said that it is not 100 per cent correct that we limit ourselves to general measures only, because I must admit that our bank law gives us also the power to limit and restrict certain types of credit. By the expression "certain type of credit" is, for example, meant investment credit as against credit for purposes of inventory financing, but also hire-purchase credit, for example, might be a special type of credit, and we indeed have sometimes by moral suasion influenced the banks in the amount of hire-purchase financing they should do. However, I consider this as only a slight deviation from the formulation in the sentence you quoted, the consideration being that you would like credit to be used as much as possible for productive purposes and not for stimulating consumption.

COMMISSIONER LEMAN: As background for this, could you tell us generally how much the consumer loan volume is in the Netherlands?

DR. HOLTROP: It is specifically low. The other day I saw an international comparison where we are at the bottom, and the total amount of hire-purchase credit or instalment credit is, I think, not more than 2 per cent of national income. We have a figure there of 40 billion, so the total amount outstanding would definitely be below 800 million guilders or 700 million guilders. A large part of that would include credit for professional automobiles financing.

So, the purely consumptive part of our hire-purchase financing is definitely low in our country.

THE CHAIRMAN: What is the value of a guilder now?

DR. HOLTROP: Thirty per cent of a Canadian dollar, to make it easy.

COMMISSIONER LEMAN: How about the very large corporations operating in Holland that are, let us say, we will call them international corporations that have access to foreign funds quite easily? Have you ever used any moral suasion with them?

DR. HOLTROP: No. There you touch upon a highly interesting problem which I think central banking generally and monetary policy in the future are facing, and that is the internationalization of our whole economies. It is perfectly true that the possibility of financing yourself with foreign means brings you outside the control of your local central bank, and having access to a foreign banking system makes the rules, which the internal banking system or the central bank has, ineffective as far as you are concerned. If you have a very high proportion of foreign industries which have the choice of financing themselves in other countries, it definitely weakens the possibilities of monetary policy, in my opinion. This may be even more important in your country than with us. With us it is of a certain importance, but I can visualize with the growth of the common market it may become more and more important, because it is a fact that, so far, monetary policy is completely handled on a national basis. If we make restrictive measures

So, the purely consumptive part of our hire-purchase financing is definitely low in our country.

THE CHAIRMAN: What is the value of a guilder?

DR. HOLTROP: Thirty per cent of a Canadian dollar, to make it easy.

COMMISSIONER LEMAN: How about the very large corporations operating in Holland that are, let us say, we will call them international corporations that have access to foreign funds quite easily? Have you ever used any moral suasion with them?

DR. HOLTROP: No. There you touch upon a highly interesting problem which I think central banking generally and monetary policy in the future are facing, and that is the internationalization of our whole economies. It is perfectly true that the possibility of financing yourself with foreign means brings you outside the control of your local central bank, and having access to a foreign banking system makes the rules which the internal banking system or the central bank has ineffective as far as you are concerned. If you have a very high proportion of foreign industries which have the choice of financing themselves in other countries, it definitely weakens the possibilities of monetary policy in my opinion. This may be even more important in your country than with us. With us it is of a certain importance but I can visualize with the growth of the common market it may become more and more important, because it is a fact that, so far, monetary policy is completely handled on a national basis. If we make restrictive measures

for our banking system, we make restrictive measures for the loans they make within the country, and leave them free -- well, we allow them to make loans outside the country, and those loans they make outside the country would not come under the control of the central bank of that country. It is a very interesting point: that with the internationalization of the world the control of national banking systems tends to weaken.

--- Luncheon adjournment.

[illegible] country would not come under the control of the central bank of that country. It is a very interesting point:that with the internationalization of the world the control of national banking systems tends to weaken.

[illegible]

--- On resuming at 2.15 P.M.

THE CHAIRMAN: Dr. Holtrop, with reference to near banks, the agricultural credit banks would not be classed as near banks?

DR. HOLTROP: No, they are classified as banks.

THE CHAIRMAN: Yes, because they accept deposits as a business?

DR. HOLTROP: Yes.

THE CHAIRMAN: And the security credit institutions you mention in your memorandum: would they be near banks, or would they be banks?

DR. HOLTROP: All those that are of any importance and at the same time taking deposits and making loans are classified as banks.

THE CHAIRMAN: That is their business?

DR. HOLTROP: Yes.

THE CHAIRMAN: What is the difference? What is the distinguishing feature of the security credit?

DR. HOLTROP: They are really what you would call stock brokers. They are somewhat developed stock brokers, who do some part of the banking business for this private clients. A stock broker pure and simple might not take deposits and might not make loans. A stock broker with private clients has a kind of small banking business because he may take deposits in the sense that any surplus liquidity of his clients may be left with him, and so it is a form of taking deposits. If he also makes loans, then we classify him as a security credit institution: that is, he is not a member of the

--- On resuming at 2.15 P.M.

THE CHAIRMAN: Dr. Holtrop, with reference to near banks, the agricultural credit banks would not be classed as near banks?

DR. HOLTROP: No, they are classified as banks.

THE CHAIRMAN: Yes, because they accept deposits as a business?

DR. HOLTROP: Yes.

THE CHAIRMAN: And the security credit institutions you mention in your memorandum: would they be near banks, or would they be banks?

DR. HOLTROP: All those that are of any importance and at the same time taking deposits and making loans are classified as banks.

THE CHAIRMAN: That is their business?

DR. HOLTROP: Yes.

THE CHAIRMAN: What is the difference? What is the distinguishing feature of the security credit?

DR. HOLTROP: They are really what you would call stock brokers. They are somewhat developed stock brokers, who do some part of the banking business for this private clients. A stock broker pure and simple might not take deposits and might not make loans. A stock broker with private clients has a kind of small banking business because he may take deposits in sense that any surplus liquidity of his clients may be left with him, and so it is a form of taking deposits. If he also makes loans, then we classify him as a security credit institution: that is, he is not a member of the

Bankers' Association. He is from a monetary point of view of minor importance, but he comes under the same rules of supervision of ours. If his business is developed to any importance, then he comes in the classification of banks.

COMMISSIONER MACKINTOSH: To turn the Chairman's question around, what in your country would you think of as near banks?

DR. HOLTROP: Well, the nice thing is we haven't got them, really. It makes many of our problems so simple, because I recognize that in the situation as you know it here -- and as it is also known in other Anglo-Saxon countries: for example, in South Africa, that you have to cope with a problem in deciding how to handle the near banks. We know the financing institutions which you might say are near banks because they are in the banking business, but with us they don't take deposits. They finance themselves by loans, not by deposits.

THE CHAIRMAN: Those are the finance companies.

DR. HOLTROP: Hire-purhcase finance companies. They may be subsidiaries of banks. We hardly ever discuss in our country the problem of near banks because we do not have a category of institutions that creates that problem.

THE CHAIRMAN: You have the statutory power to control all these institutions?

DR. HOLTROP: As soon as they take deposits and make loans, then they are by statute under our control.

THE CHAIRMAN: The hire-purchase companies, apparently -- at least, from my understanding of what

Bankers' Association. He is from a monetary point of view of minor importance, but he comes under the same rules of supervision of ours. If his business is developed to any importance, then he comes in the classification of banks.

[illegible] question around, what in your country would you think of as near banks?

DR. HOLTROP: Well, the nice thing is we haven't got them, really. It makes many of our problems so simple, because I recognize that in the situation as you know it here -- and as it is also known in other Anglo-Saxon countries: for example, in South Africa, that you have to cope with a problem in deciding how to handle the near banks. We know the financing institution which you might say are near banks because they are in the banking business, but with us they don't take deposits. They finance themselves by loans, not by deposits.

THE CHAIRMAN: Those are the finance companies.

DR. HOLTROP: Hire-purchase finance companies. They may be subsidiaries of banks. We hardly ever discuss in our country the problem of near banks because we do not have a category of institutions that creates that problem.

THE CHAIRMAN: You have the statutory power to control all these institutions?

DR. HOLTROP: As soon as they take deposits and make loans, then they are by statute under our control.

THE CHAIRMAN: The hire-purchase companies, apparently -- at least, from my understanding of what

you had said this morning -- are probably the largest group of companies that deal in what you might call near banking business.

DR. HOLTROP: They are not under our control.

THE CHAIRMAN: Most of them do not accept deposits in the ordinary sense?

DR. HOLTROP: No, they don't. The situation may have been influenced by our legislation, but also before the legislation was there we never had developed the tradition of institutions which were taking deposits for that purpose. Those institutions which specialize in hire-purchase financing have always taken long-term borrowing from the market and have been partly financed also for their surplus requirements by the banks themselves. Many of them are subsidiaries of the banks.

THE CHAIRMAN: You say at page 35 in paragraph (d):

> "A useful indication of the monetary significance of the institutions concerned might be found in the velocity of turnover of their deposits, or of any special group of their deposits. I believe that any yearly velocity of turnover in excess of unity should be looked upon with suspicion."

you had said this morning -- are probably the largest group of companies that deal in what you might call [illegible]

DR. HOLTROP: They are not under our control.

THE CHAIRMAN: Most of them do not accept deposits in the ordinary sense?

DR. HOLTROP: No, they don't. The situation may have been influenced by our legislation, but also before the legislation was there we never had developed the tradition of institutions which were taking deposits for that purpose. Those institutions which specialize in hire-purchase financing have always taken long-term borrowing from the market and have been partly financed also for their surplus requirements by the banks themselves. Many of them are subsidiaries of the banks.

THE CHAIRMAN: You say at page 35 in paragraph (d):

"A useful indication of the monetary significance of the institutions concerned might be found in the velocity of turnover of their deposits, or of any special group of their deposits. I believe that any yearly velocity of turnover in excess of unity should be looked upon with suspicion."

Could you elaborate on that a bit?

DR. HOLTROP: I am not sure whether the wording is exactly what I mean. You ask me a theoretical question about a situation which we do not know in our own country. We might know something comparable to it in the case of some of our savings banks which have developed in such a way that they have been giving facilities to their customers that really come into the range of near bank facilities. The rate of turnover of their deposits may then increase with the facilities they give. If these facilities include the making of payments directly out of the account, and taking care of and accepting automatic deposits out of pension payments, for example, and things like that, they may develop such accounts into a kind of cash reserve for the holders of these deposits. They then get near to what I call the money supply. But, generally, we find that the average rate of turnover in the savings accounts in Holland is well below one-half. So, the average time of deposit is over two years, which identifies them clearly as real savings deposits. When the rate of turnover gets below one, the average time of deposit is less than a year and you get into the sphere of institutions which might just be an intermediate in the use of monies that are only seasonally available. In my way of thinking they get into the monetary sphere. For private people the fluctuation in their cash balances may be connected with the time of the payments of incomes, so they may have monthly fluctuations, but in business there are seasonal fluctuations many businesses will have surplus funds during a part of the year and be somewhat short of funds

Could you elaborate on that a bit?

DR. HOLTROP: I am not sure whether the wording is exactly what I mean. You ask me a theoretical question about a situation which we do not know in our own country. We might know something comparable to it in the case of some of our savings banks which have developed in such a way that they have been giving facilities to their customers that really come into the range of near bank facilities. The rate of turnover of their deposits may then increase with the facilities they give. If these facilities include the making of payments directly out of the account, and taking care of and accepting automatic deposits out of pension payments, for example, and things like that, they may develop such accounts into a kind of cash reserve for the holders of these deposits. They then get near to what I call the money supply. But, generally, we find that the average rate of turnover in the savings accounts in Holland is well below one-half. So, the average time of deposit is over two years, which identifies them clearly as real saving deposits. When the rate of turnover gets below one, the average time of deposit is less than a year and you get into the sphere of institutions which might just be an intermediate in the use of monies that are only seasonally available. In my way of thinking they get into the monetary sphere. For private people the fluctuation in their cash balances may be connected with the time of the payments of incomes, so they

and make use of bank loans in another part. The institutions who would make use of these temporary deposits which become available for only part of the year and who by their substitution can create a permanent line of credit on the basis of these temporary deposits, very clearly are in the sphere of monetary action. This is a technique of increasing the velocity of circulation of money, or of the creation of money when you really recognize that the deposits they take have the function of cash money for the depositors. Taking the one-year period, as soon as you get beyond a velocity over one, then apparently you are already receiving monies that are only for a part of the year available in the hands of the depositor, and therefore you get into the monetary sphere. Do I make myself clear?

THE CHAIRMAN: Yes, I think I understand.

DR. HOLTROP: It is mainly the seasonal factor that I have in mind there.

COMMISSIONER LEMAN: If your consumer finance companies use mostly medium and long-term funds, would it follow that their rates to the consumer would tend to be higher than those who would be allowed to use very short-term and even deposit money?

DR. HOLTROP: As far as I know, in hire-purchase financing effective rates tend to be higher than the rates for bank loans, and certainly for prime bank loans. Consequently there would be some margin there for a somewhat more costly way of financing and for all the administration involved.

COMMISSIONER BROWN: Have banks gotten into that field?

DR. HOLTROP: They have got to a certain extent in that field. We have a bit discouraged it. I think in the middle 50's we had, by way of moral suasion, asked the banks to limit the expansion of their loans and their financing to hire-purchase finance companies. In the course of time they have taken an interest in these companies and some of them have been taken over by important banks, so banks have a certain stature in this field.

COMMISSIONER BROWN: Are the banks making the loans directly?

DR. HOLTROP: No, they are using these companies for that purpose.

COMMISSIONER LEMAN: Dr. Holtrop, I have a couple of questions to ask you about the effectiveness of monetary policy as managed by a central bank.

DR. HOLTROP: Yes.

COMMISSIONER LEMAN: This morning in answer to some of our questions you have covered a lot of ground, so that in part my questions may come back a little to what you have said; I am not too sure if some of the answers might not be on the record already, but I am not sure because they didn't come to you as questions specifically on these points.

One of them is your strong feeling, apparently, that in this field it is much more the confidence in the availability of money for business purposes that will influence the results you were trying to achieve,

that field?

DR. HOLTROP: They have got to a certain extent in that field. We have a bit discouraged it. I think in the middle 50's we had, by way of moral suasion, asked the banks to limit the expansion of their loans and their financing to hire-purchase finance companies. In the course of time they have taken an interest in these companies and some of them have been taken over by important banks, so banks have a certain stature in this field.

the loans directly?

DR. HOLTROP: No, they are using these companies for that purpose.

COMMISSIONER LEMAN: Dr. Holtrop, I have a couple of questions to ask you about the effectiveness of monetary policy as managed by a central bank.

COMMISSIONER LEMAN: This morning in answer to some of our questions you have covered a lot of ground, so that in part my questions may come back a little to what you have said; I am not too sure if some of the answers might not be on the record already, but I am not sure because they didn't come to you as questions specifically on these points.

One of them is your strong feeling, apparently, that in this field it is much more the confidence in the availability of money for business purposes that will influence the results you were trying to achieve,

rather than just the price of the money. I believe yesterday a witness told us that he felt that in certain circumstances where the pressure of demand is not so high, where we are not in a very strong and durable boom sort of atmosphere, then he believes that the price was quite an important factor. Could you state your position a little bit more precisely?

DR. HOLTROP: I think this has ever been a controversial point. This is also true in economic literature, also there are different attitudes, different opinions have been taken. It has always been stressed and it is generally known that in long-term financing public utilities and house building are examples of types of financing where the rate of interest plays an important role. It is also true that the expectations about the rate of interest will play a certain role in investment decisions. In the field of short-term financing it has always been held that the rate of interest does play a role in the financing of inventories, as the cost of carrying stocks is, of course, partly determined by the rate of interest.

I do not know, however, of investigations that have been properly done in this field to measure any elasticity of demand; or to determine the reaction of trade and industry to fluctuating in the rate of interest, in respect of the volume of their stocks. I would still say, that in the speculative

rather than just the price of the money. I believe yesterday a witness told us that he felt that in certain circumstances where the pressure of demand is not so high, where we are not in a very strong and durable boom sort of atmosphere, then he believes that the price was quite an important factor. Could you state your position a little bit more precisely?

DR. HOLTROP: I think this has ever been a controversial point. This is also true in economic literature, also there are different attitudes, different opinions have been taken. It has always been stressed and it is generally known that in long-term financing public utilities and house building are examples of types of financing where the rate of interest plays an important role. It is also true that the expectations about the rate of interest will play a certain role in investment decisions. In the field of short-term financing it has always been held that the rate of interest does play a role in the financing of inventories, as the cost of carrying stocks is, of course, partly determined by the rate of interest.

I do not know, however, of investigations that have been properly done in this field to measure any elasticity of demand; or to determine the reaction of trade and industry to fluctuating in the rate of interest, in respect of the volume of their stocks. I would still say, that in the speculative

field, if you have expectations of a price rise, these will easily outstrip the difference in cost due to different rates of interest. So there I doubt whether the rate of interest is of such importance in the calculation of the borrower.

We must, moreover, make clear that if you ask this question you ask not what influence the rate of interest may have on the way of financing, but on the volume of the expenditure, whether the volume of expenditure is influenced by the rate of interest and whether somebody will abstain from a certain investment because the rate of interest is one per cent higher or whether he may abstain from carrying a certain amount of stocks because the rate of interest is one per cent higher. There I am inclined to think that the consideration of ability of being able to get financing is of more importance than the rate as such, and that the influence of a raise of the discount rate -- that is the increas of the rate of discount as it has been mostly used in Europe, as a signal from the central bank -- on the volume of expenditure,is rather based on the warning effect than on the cost effect. When the rate of discount goes up it is a warning for everybody that apparently the central bank sees a certain limitation of financing possibilities in the future. That warning to the business community will be taken into consideration in all the long and short-term investment decisions; but that will not then be, in my opinion a reaction to the increase in rate as such, but rather to the expectation of the financing possibilities and the expectation of the business cycle.

field, if you have expectations of a price rise, these will easily outstrip the difference in cost due to different rates of interest. So there I doubt whether the rate of interest is of such importance in the calculation of the borrower.

We must, moreover, make clear that if you ask this question you ask not what influence the rate of interest may have on the way of financing, but on the volume of the expenditure, whether the volume of expenditure is influenced by the rate of interest and whether somebody will abstain from a certain investment because the rate of interest is one per cent higher or whether he may abstain from carrying a certain amount of stocks because the rate of interest is one per cent higher. There I am inclined to think that the consideration of ability of being able to get financing is of more importance than the rate as such, and that the influence of a raise of the discount rate -- that is the increas of the rate of discount as it has been mostly used in Europe, as a signal from the central bank -- on the volume of expenditure is rather based on the warning effect that on the cost effect. When the rate of discount goes up it is a warning for everybody that apparently the central bank sees a certain limitation of financing possibilitie in the future. That warning to the business community wil be taken into consideration in all the long and short-te investment decisions; but that will not then be, in my opinion a reaction to the increase in rate as such, but to the expectation of the financing possibilities and th

So, the answer is, indeed that I am inclined to believe that the elasticity of demand for credit to the rate of interest is not very high; that there are certain fields where we know that it is of importance -- and I have mentioned them -- but that in other fields the elasticity is rather rigid and that therefore it is not purely the rate to which a business community reacts, but far more to the expectation of being able to finance.

COMMISSIONER LEMAN: Because when you are trying to influence the total rate of expenditure you are then dealing with the whole spectrum of prospective investments, and certainly in a given country there will be also a whole spectrum of profit margins ---

DR. HOLTROP: That is right.

COMMISSIONER LEMAN: And you are always looking only to influence the marginal borrower, are you not?

DR. HOLTROP: That is right.

COMMISSIONER LEMAN: so that, in theory would it not seem logical that that would at least discourage the marginal ones and that that might give you just the leverage you need for your total expenditure reduction?

DR. HOLTROP: Then, my question would be what do we know about the volume of these marginal ones; is that sufficient to get the reaction we wish or not? I would immediately answer that, as soon as you talk about the two per cent rate increase, the differences in the rate of interest would of course be that important that you get reactions. With small differences I doubt whether you do get that reaction and,

So, the answer is, indeed that I am inclined to believe that the elasticity of demand for credit to the rate of interest is not very high; that there are certain fields where we know that it is of importance -- and I have mentioned them -- but that in other fields the elasticity is rather rigid and that therefore it is not purely the rate to which a business community reacts, but far more oc the expectation of being able to finance.

COMMISSIONER LEMAN: Because when you are trying to influence the total rate of expenditure you are then dealing with the whole spectrum of prospective investments, and certainly in a given country there will be also a whole spectrum of profit margins ---

DR. HOLTROP: That is right.

COMMISSIONER LEMAN: And you are always looking only to influence the marginal borrower, are you not?

DR. HOLTROP: That is right.

COMMISSIONER LEMAN: so that, in theory would it not seem logical that that would at least discourage the marginal ones and that that might give you just the leverage you need for your total expenditure reduction?

DR. HOLTROP: Then, my question would be what do we know about the volume of these marginal ones; is that sufficient to get the reaction we wish or not? I would immediately answer that, as soon as you talk about the two per cent rate increase, the differences in the rate of interest would of course be that important that you get reactions. With small differences I doubt whether you do get that reaction and,

at any rate, I can only say that we have looked upon monetary policy in that respect more from the quantitative point of view than from the point of view that the rate of interest by itself would sufficiently influence the spending decisions of the community. I know this problem plays its part in the Radcliffe investigation also, and I understand that when you come to the point where it is impossible to observe the quantitative relations you are almost bound to believe that it is the rate of interest that will give sufficient reactions -- but I don't think we know enough to say for sure how the situation is.

COMMISSIONER MACKINTOSH: What would you think about the effect of the rate of interest on the rate of savings?

DR. HOLTROP: Again I am inclined to believe that the influence of the rate of interest is greater on the form in which you keep your savings than on the amount of the savings.

That leads to the whole question of an analysis of where savings come from. As you know, nowadays a large part of the savings come from surplus profits and there, of course, it is not the rate of interest that induces the savings, it is the profit that determines them.

Government savings is a question, of course, of taxation and volume of expenditure and isn't influenced by the rate of interest. As far as private savings are concerned I have never believed that people changed their goals in that respect because the rate of interest is one-half a per cent higher or a

[illegible]
monetary policy in that respect more from the quantitative point of view than from the point of view that the rate of interest by itself would sufficiently influence the spending decisions of the community. I know this problem plays its part in the Radcliffe investigation also, and I understand that when you come to the point where it is impossible to observe the quantitative relations you are almost bound to believe that it is the rate of interest that will give sufficient reactions but I don't think we know enough to say for sure how the situation is.

COMMISSIONER MACKINTOSH: What would you think about the effect of the rate of interest on the rate of savings?

DR. HOLTROP: Again I am inclined to believe that the influence of the rate of interest is greater on the form in which you keep your savings than on the amount of the savings.

That leads to the whole question of an analysis of where savings come from. As you know, nowadays a large part of the savings come from surplus profits and there, of course, it is not the rate of interest that induces the savings, it is the profit that determines them.

Government savings is a question, of course, of taxation and volume of expenditure and isn't influenced by the rate of interest. As far as private savings are concerned I have never believed that people changed their goals in that respect because

per cent higher. At the moment that one comes to exceptional rates people will probably buy on the short-term to profit from those rates. If you get to the "magic fives" or "sixes", or beyond, you probably get short-term reactions to profit from that rate. On the long-term I doubt whether you do.

THE CHAIRMAN: Doesn't it depend somewhat on the extent to which the institution advertises for savings? There are some institutions which advertise very vigorously to attract savings and are offering 4 per cent for deposit money, demand money, and I would think a great many people who have idle balances may be persuaded that the advertisement is sufficiently colourful and attractive ---

DR. HOLTROP: That is what I meant ---

THE CHAIRMAN: To invest their savings?

DR. HOLTROP: That is what I meant when I said that the rate of interest has more influence on the direction in which savings are being invested than on the savings themselves. Do you think that advertising will decide people not to spend their weekly income?

THE CHAIRMAN: I was thinking of the people who don't bother putting their money in a savings bank; they hold it in a current account.

DR. HOLTROP: Yes, definitely.

THE CHAIRMAN: It is very difficult.

DR. HOLTROP: Yes, I think you are right; the

per cent higher. At the moment that one comes to exceptional rates people will probably buy on the short-term to profit from those rates. If you get to the "magic fives" or "sixes", or beyond, you probably get short-term reactions to profit from that rate. On the long-term I doubt whether you do.

THE CHAIRMAN: [illegible]

[illegible] savings? There are some institutions which advertise very vigorously to attract savings and are offering 4 per cent for deposit money, demand money, and I would think a great many people who have idle balances may be persuaded that the advertisement is sufficiently colourful and attractive ---

DR. HOLTROP: That is what I meant ---

THE CHAIRMAN: To invest their savings?

DR. HOLTROP: That is what I meant when I said that the rate of interest has more influence on the direction in which savings are being invested than on the savings themselves. Do you think that advertising will decide people not to spend their weekly income?

THE CHAIRMAN: I was thinking of the people who don't bother putting their money in a savings bank; they hold it in a current account.

DR. HOLTROP: [illegible]

THE CHAIRMAN: It is very difficult.

DR. HOLTROP: Yes, I think you are right; the

rate of interest will certainly influence it, but it is not the volume of saving by itself, it is the form of the savings. I definitely agree that the rate of interest has an influence on the amount of liquid wealth people will hold in the form of money or near money; we observe that also, and that is one of the reasons why we have ourselves in our monetary analysis rather given up to work with the notion of money proper, and are giving more value to the notion of liquidity -- that is money and near money together -- because we indeed believe that the rate of interest influences people in putting money in a bank or an institution or holding it in cash, and also that the business community will be decided by the rate of interest whether they go to the trouble of putting it on deposit or holding it in a current account.

COMMISSIONER BROWN: Do you think we will get into perverse reactions when interest rates start to go up so businesses that fear non-availability of credit will obtain it now rather than take the chance of waiting?

DR. HOLTROP: No, we haven't observed that to any extent, no. If you make intricate restrictive regulations then you might indeed incite that kind of reaction -- but under normal conditions of practice in the rate of interest we have not observed that, no.

rate of interest will certainly influence it, but it is not the volume of saving by itself, it is the form of the savings. I definitely agree that the rate of interest has an influence on the amount of liquid wealth people will hold in the form of money or near money; we observe that also, and that is one of the reasons why we have ourselves in our monetary analysis rather given up to work with the notion of money proper, and are giving more value to the notion of liquidity -- that is money and near money together -- because we indeed believe that the rate of interest influences people in putting money in a bank or an institution or holding it in cash, and also that the business community will be [illegible] trouble of putting it on deposit or holding it in a current [illegible].

COMMISSIONER BROWN: Do you think we will get into perverse reactions when interest rates start to go up so businesses that fear non-availability of credit will obtain it now rather than take the chance of waiting?

DR. HOLTROP: No, we haven't observed that to any extent, no. If you make intricate restrictive regulations then you might indeed incite that kind of reaction -- but under normal conditions of practice in the rate of interest we have not observed that, no.

COMMISSIONER GIBSON: You put a great deal of emphasis in discussing how monetary policy works on expectations; money will be hard to get or will not be available, and I take it this is the most important way in which you think it actually works. Now, what about expectations that the business climate might change which is induced by a change in central bank policy? Do you think this is an important factor, the thought that business may change or that the boom is pretty nearly over in the central bank's opinion in making postponed decisions to invest?

DR. HOLTROP: It may indeed play a role. But I am inclined not to believe that the raising of the discount rate by itself -- at any rate, in our own circumstances -- would for that reason only create sufficient of an expectation that the boom will be broken.

COMMISSIONER GIBSON: As an additional reaction, but what is your opinion as to the most important?

DR. HOLTROP: If you are increasing the rate of discount in time so that it is well before there is a break in the boom, there are so many reasons to believe that conditions, after all, are very favourable for investment, that the sheer fact that the discount rate is raised will only be a warning to a few people. The choice of the way of financing will perhaps be influenced already in an early period because people will feel that the discount rate being raised might indicate

[illegible]

[illegible]

on expectations; money will be hard to get or will not be available, and I take it this is the most important way in which you think it actually works. Now, what about expectations that the business climate might change which is induced by a change [illegible] change or that the boom is pretty nearly over in the central bank's opinion in making postponed decisions to invest?

DR. HOLTROP: It may indeed play a role. But I am inclined not to believe that the raising of the discount rate by itself -- at any rate, in our own circumstances -- would for that reason only create sufficient of an expectation that the boom will be broken.

COMMISSIONER GIBSON: As an additional reaction, but what is your opinion as to the most [illegible]

DR. HOLTROP: If you are increasing the rate of discount in time so that it is well before there is a break in the boom, there are so many reasons to believe that conditions, after all, are very favourable for investment, that the sheer fact that the discount rate is raised will only be a warning to a few people. The choice of the way of financing will perhaps be influenced already in an early period because people I feel that the discount rate being raised might indi

higher interest rates in the future -- it certainly will then be an incentive to go at an earlier time to the long-term market.

COMMISSIONER LEMAN: To put Mr. Gibson's question in a slightly different form, if they become convinced that monetary policy is effective, and therefore successful, then it could lead to the kind of conclusion which Mr. Gibson is suggesting?

DR. HOLTROP: This is also speculative, I think we can't know about these things. This is all conjecture and different people will react in a different way, and I would not say that it is my expectation that the mere fact of restrictive policy would create an atmosphere of expectation of a turn in the business cycle and that by that reason only investment decisions are already influenced to a large extent. I think that would go a bit too far.

COMMISSIONER GIBSON: Would it be fair to say that if the action was very strong, such as the British increase in the bank rate of 7 per cent?

DR. HOLTROP: Yes, but that is another thing. There you are quite right. Certainly if you live in a situation of inflationary expectancies and then suddenly government and central bank policy together show that the authorities are not going to allow these conditions to continue, then, of course, you might break the inflationary expectancies and that might have a forceful influence. I think that indeed the jumps we have had from 5 to 7 per cent have worked that way. In Holland in 1957 we had a slight foreign exchange crisis and then

[illegible]

will then be an incentive to go at an earlier time

[illegible]

[illegible]: To put Mr. Gibson's question in a slightly different form, if they become convinced that monetary policy is effective, and therefore successful, then it could lead to the kind of conclusion which Mr. Gibson is suggesting?

DR. HOLTROP: This is also speculative, I think we can't know about those things. This is all conjecture and different people will react in a different way, and I would not say that it is my expectation that the mere fact of restrictive policy would create an atmosphere of expectation of a turn in the business cycle and that by that reason only investment decisions are already influenced to a large extent. I think that would go a bit too far.

COMMISSIONER GIBSON: Would it be fair to say that if the action was very strong, such as the British increase in the bank rate of 7 per cent?

DR. HOLTROP: Yes, but that is another thing. There you are quite right. Certainly if you live in a situation of inflationary expectancies and then suddenly government and central bank policy together show that the authorities are not going to allow these conditions to continue, then, of course, you might break the inflationary expectancies and that might have a forceful influence. I think that indeed the jumps we have had from 5 to 7 per cent have worked that way.

[illegible] 1957 we had a slight foreign exchange

there was also a forceful increase in the rate of interest; well, it not only helped to recreate confidence but also was a warning to the business community that these exceptional expenditures shouldn't be allowed to continue, and that certainly gave a reaction.

COMMISSIONER LEMAN: Dr. Holtrop, to go on to a slightly different point from that Mr. Gibson touched on this morning, but still in the realm of effectiveness of monetary policy, you have explained to us that it has a very limited role, and must be used only in the way and in the field in which it can be effective. But, within that limited area, have you in the Netherlands attempted to make fairly precise measurements of how fast it works, or as to how long it takes for the turn around to come about, et cetera.

DR. HOLTROP: No, we have not make measurements of lags because I do not think the thing is pointed enough for that purpose. With respect to countries like the Netherlands it is the general business atmosphere and the business cycle in the world which play an enormous role in the business community. Take, for example, the turn of the cycle in 1957. Having the benefit of hindsight it appears that the turn in the cycle came exactly at the same time as in the United States, so in that case you come to the conclusion that the real turn of the cycle was after all influenced by general world conditions, and was not purely a consequence of local monetary policies. Local monetary policies certainly have helped in restraining the exaggeration of the cycle, but the fundamental development of the cycle was apparently governed by general conditions in the world. So, this would make it difficult to make close observations of the lags in reaction to policy measures.

After all, in these phenomena you can

Mr. Gibson touched on this morning, but still in the realm of effectiveness of monetary policy, you have explained to us that it has a very limited role, and must be used only in the way and in the field in which it can be effective. But, within that limited area, have you in the Netherlands attempted to make fairly precise measurements of how fast it works, or as to how long it takes for the turn around to come about, et cetera.

DR. HOLTROP: No, we have not made measurements of lags because I do not think the thing is pointed enough for that purpose. With respect to countries like the Netherlands it is the general business atmosphere and the business cycle in the world which play an enormous role in the business community. Take, for example, the turn of the cycle in 1957. Having the benefit of hindsight it appears that the turn in the cycle came exactly at the same time as in the United States, so in that case you come to the conclusion that the real turn of the cycle was after all influenced by general world conditions, and was not purely a consequence of local monetary policies. Local monetary policies certainly have helped in restraining the exaggeration of the cycle, but the fundamental development of the cycle was apparently governed by general conditions in the world. So, this would make it difficult to make close observations of the lags in reaction to policy meas

After all, in these phenomena you can

observe what happens, but you never know what would have happened without your policy. Even at the present moment, more than a year after we applied restrictive measures we cannot be quite sure about the results of the measures because we cannot know what would have happened if we had not taken those measures.

I can only observe, for example, that the expansion of credit has slowed down when compared with the period before. I cannot know what the exact difference would have been as between what would have happened without the measures and what has happened with the measures. In that respect, what you do is necessarily tentative.

There is always, of course, the matter of lags because when I say your ultimate purpose is to influence expenditure the fact has to be recognized that monetary policy, in the first instance, often only has an influence on the ways of financing, and the choice of ways of financing only indirectly affects expenditure. Ways of financing influence the future expenditure, because when shifting from bank loans to the capital market you take away the means of financing of other people who might have used them quite some time later and who at that later time do not find the means of financing, and who by then have to change their investment plans.

I do not think that close observation there is really possible, but by deduction you know there always must be lags.

Another thing is that in the superficial movements you can find quite prompt reactions. In so far as

have happened without your policy. Even at the present moment, more than a year after we applied restrictive measures we cannot be quite sure about the results of the measures because we cannot know what would have happened if we had not taken those measures.

I can only observe, for example, that the expansion of credit has slowed down when compared with the period before. I cannot know what the exact difference would have been as between what would have happened without the measures and what has happened with the measures. In that respect, what you do is necessarily tentative.

There is always, of course, the matter of lags because when I say your ultimate purpose is to influence expenditure the fact has to be recognized that monetary policy, in the first instance, often only has an influence on the ways of financing, and the choice of ways of financing only indirectly affects expenditure. Ways of financing influence the future expenditure, because when shifting from bank loans to the capital market you take away the means of financing of other people who might have used them quite some time later and who at that later time do not find the means of financing, and who by then have to change their investment plans.

I do not think that close observation there is really possible, but by deduction you know there always must be lags.

your monetary policy has the other objective -- not the fundamental objective of influencing expenditure, but, for example, the objective of defending your foreign exchange reserves -- you do find prompt reactions there. If you increase the rate of interest by 2 per cent, you will get a reflex reaction of funds to the money market, and that reaction will be very prompt. Those are superficial movements; it is indeed movement you want, but they are not the fundamental movements in total expenditures to be induced by monetary policy as such.

COMMISSIONER LEMAN: But, in general, selective controls act rather fast?

DR. HOLTROP: Do you mean selective controls in the sense ---

COMMISSIONER LEMAN: In the sense that you have used them within the general definition of moral suasion.

DR. HOLTROP: The moral suasion controls were not really effective. We have known periods in early times after the war where our system of control of credit was purely on a selective basis -- namely on the qualitative basis. That was still based on the war economy rules, and the banks had to submit to us any loan above 50,000 guilders for our approval. There you had purely selective controls, but we have never been satisfied with them. We have been glad to give them up after a few years and change them for the system of general quantitative controls as foreseen in the present act.

COMMISSIONER LEMAN: I have one more question,

[illegible]r monetary policy has the other objective -- not [illegible]amental objective of influencing expenditure, but, for example, the objective of defending your foreign exchange reserves -- you do find prompt reactions there. If you increase the rate of interest by 2 per cent, you will get a reflex reaction of funds to the money market, and that reaction will be very prompt. Those are superficial movements; it is indeed movement you want, but they are not the fundamental movements in total expenditures to be induced by monetary policy as such.

COMMISSIONER [illegible] controls act rather fast?

DR. HOLTROP: Do you mean selective controls in the sense ---

COMMISSIONER LEMAN: In the sense that you have used them within the general definition of moral suasion

DR. HOLTROP: The moral suasion controls were not really effective. We have known periods in early times after the war where our system of control of credit was purely on a selective basis -- namely on the qualitative basis. That was still based on the war economy rules, and the banks had to submit to us any loan above 50,000 guilders for our approval. There you had purely selective controls, but we have never been satisfied with them. We have been glad to give them up after a few years and change them for the system of general quantitative controls as foreseen in the present act.

COMMISSIONER LEMAN: I have one more question

Dr. Holtrop. It is not strictly in the same field, but this morning you described to us how one must take a look at all the major economic factors that have to be dealt with, and you said that some of the monetary policies were not well adapted to bring about cures in such things as certain types of unemployment, et cetera. In your country is there a super-economic council, if you might call it that, that looks at these things, or is that done mostly by the bank, or is it done somewhere else in government? Is there a recognized economic advisory board, or something of that type?

DR. HOLTROP: I have to answer that question in two ways. There are two different things. On the one hand there is what we call the Central Planning Bureau which really is the economic research department of the government. This is a branch of government. It is in the ministry of economic affairs, and it has a very high professional standing. It analyses the trends of the economy. It was built up under the leadership of Professor Tinbergen who was the first director of the institute. It worked out a so-called model for the Netherlands economy which has made it possible, on the basis of the suppositions of that model, to say what the probable consequences would be of possible policy measures. Every year it makes a plan for the next year which is a great help to the government in making up its budget, and, generally, in the forming of an opinion about what is, or is not, admissible as development in the fields of wages, prices, et cetera,

Dr. Holtrop. It is not strictly in the same field, but this morning you described to us how one must take a look at all the major economic factors that have to be dealt with, and you said that some of the monetary policies were not well adapted to bring about cures in such things as certain types of unemployment, et cetera. In your country is there a super-economic council, if you might call it that, that looks at these things, or is that done mostly by the bank, or is it done somewhere else in government? Is there a recognized economic advisory board, or something of that type?

DR. HOLTROP: I have to answer that question in two ways. There are two different things. On the one hand there is what we call the Central Planning Bureau which really is the economic research department of the government. This is a branch of government. It is in the Ministry of Economic Affairs, and it has a very high professional standing. It analyses the trends of the economy. It was built up under the leadership of Professor Tinbergen who was the first director of the institute. It worked out a so-called model for the Netherlands economy which has made it possible, on the basis of the suppositions of that model, to say what the probable consequences would be of possible policy measures. Every year it makes a plan for the next year which is a great help to the government in making up its budget, and, generally, in the forming of an opinion about what is, or is not, admissible as development in the fields of wages, prices, et cetera,

in the economy.

I must say that I think the work of this bureau is of the highest importance. Also we as a central bank co-operate with the Central Planning Bureau inasmuch as we supply them with financial data, and we consult with them on financial interpretations.

They have introduced into this model certain supposition about the reactions of the economy to a less liquid state and to a more liquid state, and more specifically to the effect of the liquidity of business on the volume of investments, for instance. We ourselves place very much value upon their estimates which partly influence our own policies.

For example, in the determination of admissible growth of bank loans we have taken into consideration the estimates of the Central Planning Bureau about the increase in real income that was to be expected under the present conditions in the current year. The Central Planning Bureau is, therefore, purely an economic advisory body, and not at all a policy-making body. It is simply a help to the government.

On the other hand, we have another body which is representative of the community as a whole. It is called the Social Economic Council. The Social Economic Council is a body of 45 members representing the business community in the sense that one-third of its members represent the entrepreneurial organizations; one-third represent the trade

unions, and the other one-third are members appointed by the government. I myself belong to this body as a government appointee.

By law the government has to submit to this body for its advice any important bill which it intends to present to parliament, so that any legislation in the economic field which the government plans to make has to be submitted to this body for advice. It is an advisory body, and it plays an important role.

It plays an important role also in the discussion of economic conditions in the country, and of economic expectations. It plays a role also in labour-entrepreneur relationships, and this, again, is in an advisory capacity. The director of the Central Planning Bureau is one of the government members of this body, he being one of the fifteen government representatives. The Central Planning Bureau also functions as the supplier of the economic data to this body, and in its consideration and investigation of problems the Central Planning Bureau will supply it with the statistical background. So, it will be seen there is co-operation between these two bodies.

Does this sufficiently answer your question?

COMMISSIONER LEMAN: Yes, but the bank forms its own judgment?

DR. HOLTROP: Yes, the bank is completely separate. The bank forms its own judgment, but it

members appointed by the government. I myself belong to this body as a government appointee.

By law the government has to submit to this body for its advice any important bill which it intends to present to parliament, so that any legislation in the economic field which the government plans to make has to be submitted to this body for advice. It is an advisory body, and it plays an important role.

It plays an important role also in the discussion of economic conditions in the country, and of economic expectations. It plays a role also in labour-entrepreneur relationships, and this, again, is in an advisory capacity. The director of the Central Planning Bureau is one of the government members of this body, he being one of the fifteen government representatives. The Central Planning Bureau also functions as the supplier of the economic data to this body, and in its consideration and investigation of problems the Central Planning Bureau will supply it with the statistical background. So, it will be seen there is co-operation between these two bodies.

Does this sufficiently answer your question?

COMMISSIONER LEMAN: Yes, but the bank forms its own judgment?

DR. HOLTROP: Yes, the bank is completely

te. The bank forms its own judgment, but it

definitely uses the material supplied to it by the Central Planning Bureau, and works in close contact with the Central Planning Bureau. However, as regards bank policy, that is completely a bank responsibility, and is not involved in the responsibility of the Social Economic Council.

COMMISSIONER LEMAN: And these bodies are more concerned with the somewhat longer range phenomena than the bank is?

DR. HOLTROP: That is right, because in this respect they are mainly concerned with legislation, and only then in an advisory capacity.

COMMISSIONER BROWN: Mr. Chairman and Dr. Holtrop, I wonder if I may move along to your techniques of debt management. Perhaps the way of opening up this subject would be to ask you to tell us of the routine that is carried out when some new long term or short term borrowings are proposed on the part of the government. I gather the government operates its own agency on this?

DR. HOLTROP: Yes. The peculiar thing, of course, is that from the point of view of a country where debt management plays such an important role it is queer to look at a country where debt management plays such a relatively unimportant role. In that respect my country is different from yours. Debt management in my country is completely the responsibility of government.

The tradition in the last ten years, I might say, of government has been that with respect

[illegible]

regards bank policy, that is completely a bank responsibility, and is not involved in the responsibility of the Social Economic Council.

COMMISSIONER LEMAN: And these bodies are more concerned with the somewhat longer range phenomena than the bank is?

DR. HOLTROP: That is right, because in this respect they are mainly concerned with legislation, and only then in an advisory capacity.

COMMISSIONER BROWN: Mr. Chairman and Dr. Holtrop, I wonder if I may move along to your techniques of debt management. Perhaps the way of opening up this subject would be to ask you to tell us of the routine that is carried out when some new long term or short term borrowings are proposed on the part of the government. I gather the government operates its own agency on this?

DR. HOLTROP: [illegible] thing, of course, is that from the point of view of a country where debt management plays such an important role it is queer to look at a country where debt management plays such a relatively unimportant role. In that respect my country is different from yours. Debt management in my country is completely the responsibility of government.

The tradition in the last ten years, I might say, of government has been that with respect

to any deficit it has to finance it is considered a matter of course that it will finance through long-term borrowing. The market for long-term borrowing is completely separate from that for short-term borrowing.

Long-term borrowing is done in the capital market with loans, usually running from zero to 25 years, or from ten years to 25 years, or to 30 years, or to 40 years. The length of the term depends upon circumstances in the market, and the type of institution to which the government hopes to sell the bonds, and as to what those institutions prefer. The savings banks will have a preference for the shorter terms. Life insurance companies may have a preference for the somewhat longer terms.

This long-term borrowing is clearly borrowing out of long-ter savings -- that is, the long-term savings that get into the hands of the savings institutions, or the life insurance companies and the pension funds. Some of the money also comes from the public. There was a period in which the public did not partake very much in the bond market. They used to partake in the pre-war days, but the inflationary period of the 40's was not very conducive to investment by private people in long-term bonds. But I must say that that condition has already changed now. With high prices on the stock exchange and, later, with the drop in the market, the general public has now again become interested to a certain extent in long-term bonds. That goes back to the old pre-war Dutch tradition that anybody who had some private fortune invested part of it in bonds, though, indeed, the part that is invested in bonds today tends to be smaller

Long-term borrowing is done in the capital market with loans, usually running from zero to 25 years, or from ten years to 25 years, or to 30 years, or to 40 years. The length of the term depends upon circumstances in the market, and the type of institution to which the government hopes to sell the bonds, and as to what those institutions prefer. The savings banks will have a preference for the shorter terms. Life insurance companies may have a preference for the somewhat longer terms.

This long-term borrowing is clearly borrowing out of long-ter savings -- that is, the long-term savings that get into the hands of the savings institutions, or the life insurance companies and the pension funds. Some of the money also comes from the public. There was a period in which the public did not partake very much in the bond market. They used to partake in the pre-war days, but the inflationary period of the 40's was not very conductive to investment by private people in long-term bonds. But I must say that that condition has already changed now. With high prices on the stock exchange and, later, with the drop in the market, the general public has now again become interested to a certain extent in long-term bonds. That goes back to the old pre-war Dutch tradition that anybody who had some private fortune invested part of it in bonds, though, indeed, the part that is invested in bonds today tends to be smaller

than that of before the war.

The amount of long-term borrowing by the government will be determined, of course, by a comparison between the total amount of government expenditure and the amount of taxation. In the development of things of late the amount of taxation has been very high because we have been in boom conditions for a relatively long time. Entrepreneurial profits have been favourable and therefore tax income has been high. The result has been that the government has done relatively little borrowing for the purpose of financing its own expenditure, and the total budget, which includes the extraordinary budget, has either been in equilibrium or it has shown only a small deficit, and even so that deficit has been smaller than the total amount of long-term investment that has had to be done by the government departments themselves.

By "government department" I mean, for example, the government pension fund. In our country the investment of the government pension funds is being taken care of by an independent supervisory body which will have a certain preference for investment in government bonds. The total that government institutions have to invest is some 600 million guilders a year, and it is a long time since the government deficit has exceeded 600 million guilders a year. In recent times the deficit has always been smaller than that.

government will be determined, of course, by a comparison between the total amount of government expenditure and the amount of taxation. In the development of things of late the amount of taxation has been very high because we have been in boom conditions for a relatively long time. Entrepreneurial profits have been favourable and therefore tax income has been high. The result has been that the government has done relatively little borrowing for the purpose of financing its own expenditure, and the total budget, which includes the extraordinary budget, has either been in equilibrium or it has shown only a small deficit, and even so that deficit has been smaller than the total amount of long-term investment that has had to be done by the government departments themselves.

By "government department" I mean, for example, the government pension fund. In our country the investment of the government pension funds is being taken care of by an independent supervisory body which will have a certain preference for investment in government bonds. The total that government institutions have to invest is some 600 million guilders a year, and it is a long time since the government deficit has exceeded 600 million guilders a year. In recent times the deficit has always been smaller

On the other hand, the government has, of course, to continually make repayments on existing loans; these repayments form part of the budget, and the government has to borrow in the market for that purpose. I think that is about all I have to say about long-term financing.

With respect to short-term financing, it is a long time since the government has been engaged in additional short-term financing in the market.

The short term debt, as a matter of fact, has had the tendency to be reduced. In the continual renewal of the short term debt there is, of course, a factor of debt management, but I would say that that is not such a very important factor. It is the choice in the range between, on the shorter end of the market the three months' bills, and on the longer end of the market the five years' treasury notes. That range represents what we call short term financing, and the government will more or less adapt itself to market conditions with a certain wish always to increase the longer terms of its borrowing when she thinks the conditions are favourable. So when she thinks she can get up to five years' money at a rate which does not very much exceed the rate for a year's paper, she will have preference to place the longer term paper.

I must say that fundamentally with a stable amount of short term government debt the government has to adapt itself to the market conditions, and the market conditions are really ruled by the exigencies of those who hold short term funds for liquidity purposes. That is quite a range of people. On the one hand there is the banking system which has to hold short term government paper on which to fall back in the case of their deposits being taken out; and there are the insurance companies, and so on, and finally the business community which has liquid funds and will, to a certain extent, also invest in short term government paper, instead of placing them on deposit with the banking system.

There is free competition between these.

This situation, of course, is a situation which is presently very different from the problems of the debt management with which those countries are faced, that really have run up a very large amount of short term debt in the war years, or in other periods, and that are continuously faced by the question as tohow they could lengthen the average maturity of their debt. It is especially different from the situation in those countries where the clear division between short and long term financing does not exist. In the United States and in England this is a problem, and, as I understand, also in this country. Because of the different traditions of the market, we have that clear division between short and long term, a clear division which is accentuated by the fact that our long term debt as a rule never has fixed maturities, but it is being repaid year by year. Thus a 25-year loan -- I mean, running from zero to 25 years will on the average be repaid to the extent of 4 per cent per year. So you cannot buy a bloc of that loan and know you are going to get your money back three years hence. Consequently these loans will not have the tendency to become money market paper because you never know for sure when the individual bond you buy will be repaid, repayment being effected by a lottery system.

COMMISSIONER BROWN: Is it all done by lottery, or does the government buy in the market?

DR. HOLTROP: No, it is generally not the habit of the government to intervene in the market. In the

the problems of the debt management with which those countries are faced, that really have run up a very large amount of short term debt in the war years, or in other periods, and that are continuously faced by the question as to how they could lengthen the average maturity of their debt. It is especially different from the situation in those countries where the clear division between short and long term financing does not exist. In the United States and in England this is a problem, and, as I understand, also in this country. Because of the different traditions of the market, we have that clear division between short and long term, a clear division which is accentuated by the fact that our long term debt as a rule never has fixed maturities, but it is being repaid year by year. Thus a 25-year loan -- I mean, running from zero to 25 years will on the average be repaid to the extent of 4 per cent per year. So you cannot buy a piece of that loan and know you are going to get your money back three years hence. Consequently these loans will not have the tendency to become money market paper because you never know for sure when the individual bond you buy will be repaid, repayment being effected by a lottery system.

COMMISSIONER BROWN: Is it all done by lottery, or does the government buy in the market?

of the government to intervene in the market. In the

long term market there is, for all practical purposes, no government intervention. The bank has never intervened in the long term market yet, though we have the power to do so. We have never been in a situation where we had the feeling we needed to acquire a long term portfolio, and not having got into that situation we have never been in a position to exercise an influence on the long end of the market. The government funds do some regular buying, and there there may be some indirect intervention in that sense. I now refer to the government pension fund. But, as I already mentioned, they are managed by independent bodies, so they are not under the simple directive of the minister of finance, but under the directive of a body that controls their investment propositions. They will take their decisions in their own merits and at a certain moment will buy or sell in the market; but that is not, of course, pure government intervention.

COMMISSIONER BROWN: Perhaps I could ask you a question in which you would have a purely objective interest: that is, what is your opinion as to a central bank operating in the long term bond market?

DR. HOLTROP: I have no objection at all to the central bank, as a matter of principle, operating in the long term market, because I can see some advantages. The problem is, however, when do you build up a portfolio? You can only acquire a portfolio by inflationary action, because you create money in order to buy long term debt, unless you were to

agree with the government that the government at a certain moment would replace a part if the short term portfolio of the Bank by long term paper. That proposition has never arisen with us. Of course, theoretically, the advantage of being able to operate in the long term market is that you have a more direct action than when you only operate in the short term market. But we know from the American controversies that it is a difficult problem, because the longer term market is very sensitive to government interference; and if there is a lot of government interference you do not have a real market any more, and people may tend to distrust the market at all.

With us, we have the tradition that the long term rate of interest is not an object of policy, but it is really the result of market conditions; and being the result of market conditions every investor knows the market can go against him, but not the government or the central bank. That is also an advantage, I think.

I can only repeat, however, that we have the power. The Bank Act gives us the power also to buy long term bonds. But we have never yet been in a position to acquire them. I could conceive circumstances of depression, od depressive conditions, that would be conducive to building up a long term portfolio in the hands of the bank, namely when under depressive conditions you want to get the long term interest rate further down in order to have a stimulative effect on the market. But in Holland since the war,

[illegible] the government [illegible] certain moment would replace a part if the short term portfolio of the Bank by long term paper. That proposition has never arisen with us. Of course, theoretically, the advantage of being able to operate in the long term market is that you have a more direct action than when you only operate in the short term market. But we know from the American controversies that it is a difficult problem, because the longer term market is very sensitive to government interference; and if there is a lot of government interference you do not have a real market any more, and people may tend to distrust the market at all.

With us, we have the tradition that the long term rate of interest is not an object of policy, but it is really the result of market conditions; and being the result of market conditions every investor knows the market can go against him, but not the government or the central bank. That is also an advantage, I think.

I can only repeat, however, that we have the power. The Bank Act gives us the power also to buy long term bonds. But we have never yet been in a position to acquire them. I could conceive circumstances of depression, od depressive conditions, that would be conducive to building up a long term portfolio in the hands of the bank, namely when under depressive conditions you want to get the long term interest rate further down in order to have a stimulative effect on the market. But in Holland since the war,

those conditions have never arisen, and, therefore, we have never had to take that decision.

COMMISSIONER BROWN: What sort of relationship exists between the long term interest rate on, say, your corporate securities and a new government bond issue?

DR. HOLTROP: The difference would not be more than about half a per cent. At the present moment the government could borrow at $4\frac{1}{4}$ per cent, and good industrial bonds would be placed at 4 3/4 -- not more than half a per cent difference between the two. The municipal bonds would be just in between. Recently they have been borrowing at $4\frac{1}{2}$ per cent.

COMMISSIONER BROWN: There is one sentence on page 27, which is the last sub-paragraph of paragraph 47, where you say:

> " The bank advises the government
> with respect to the government's
> operations. It will not operate
> itself without previous consultation
> with the government."

Could you clarify that just a little? I am a trifle confused.

DR. HOLTROP: I meant it this way: the government, of course, is completely responsible for its own action in the short term market. It acts through its own agency, and the government may consult us. We have complete responsibility for our own open market policies. If, in the course of our own open market policies, we decide to sell in the market, that might

[illegible] we have never had to take that decision.

COMMISSIONER BROWN: What sort of relationship exists between the long term interest rate on, say, your corporate securities and a new government bond issue?

DR. HOLTROP: The difference would not be more than about half a per cent. At the present moment the government could borrow at $4\frac{1}{4}$ per cent, and good industrial bonds would be placed at 4 3/4 -- not more than half a per cent difference between the two. The municipal bonds would be just in between. Recently they have been borrowing at $4\frac{1}{2}$ per cent.

COMMISSIONER BROWN: There is one sentence on page 27, which is the last sub-paragraph of paragraph 47, where you say:

> '[illegible] with respect to the government's operations. It will not operate itself without previous consultation with the government.'

Could you clarify that just a little? I am a trifle [illegible]

DR. HOLTROP: I meant it this way: the government, of course, is completely responsible for its own action in the short term market. It acts through its own agency, and the government may consult us. We have complete responsibility for our own open market policies. If, in the course of our own open market policies, we decide to sell in the market, that might

counteract the short term government policy. Although we feel completely responsible for our own action, and also the government recognizes our own responsibility there -- this all being subject, of course, to the power of directive if there were a real difference of opinion about monetary policy -- we would not act in the market without first informing the government. So we would be in touch with the government and say, "Well, the conditions of the banks are such and such, and we think we should make them somewhat more liquid, so we have the intention of buying some short term paper in the market," or the reverse. Then the government would take that into consideration in their instructions to their agent about his action, because being two separate parties that action should be co-ordinated, and we should not work against one another.

COMMISSIONER BROWN: One final question on this, and that is, this government agent, is he a stock broker?

DR. HOLTROP: He is a government employee.

COMMISSIONER BROWN: He is a government employee?

DR. HOLTROP: Yes.

COMMISSIONER BROWN: He is a department?--

DR. HOLTROP: Yes, he is really a department of the government.

COMMISSIONER GIBSON: Do you regard fiscal policy as being an important element in achieving the goal of monetary policy, price stability?

[illegible] Although we feel completely responsible for our own action, and also the government recognizes our own responsibility there -- this all being subject, of course, to the power of directive if there were a real difference of opinion about monetary policy -- we would not act in the market without first informing the government. So we would be in touch with the government and say "Well, the conditions of the banks are such and such, and we think we should make them somewhat more liquid, so we have the intention of buying some short term paper in the market," or the reverse. Then the government would take that into consideration in their instructions to their agent about his action, because being two separate parties that action should be co-ordinated, and we should not work against one another.

COMMISSIONER BROWN: One final question on this, and that is, this government agent, is he a stock broker?

DR. HOLTROP: He is a government employee.

COMMISSIONER BROWN: He is a government employee?

DR. HOLTROP: Yes.

COMMISSIONER BROWN: He is a department?--

DR. HOLTROP: Yes, he is really a department of the government.

COMMISSIONER GIBSON: Do you regard fiscal policy as being an important element in achieving the goal of monetary policy, price stability?

DR. HOLTROP: I think it has become more and more important. We must realize it has become more and more important also when we compare with the pre-war economy and certainly with the pre-1914 economy, on which all our basic and classical thinking on monetary policy is still based. That was in a period when the governmnt played a small role and one in which monetary policy, therefore, worked completely through the private sector. Part of our basic and classical thinking is based on those kinds of conditions; but these conditions are not the conditions of today. In all modern countries some 25 per cent of expenditure is government expenditure, and it is only natural that if you have notions of monetary policy and notions of equilibriating the economy you should first try to apply them in the government field and not make the private economy adapt itself to the freaks of government; but, on the other hand, if possible, try to adapt government to the freaks of the private economy.

However, I do think that government policy is extremely important, and we have to think of the two different ways in which government policy can be important. There is the direct policy of expenditure and taxation of the government; that is what you would call fiscal policy. And the other way is that of the methods of financing of government expenditure; that is what you then would call part of the debt management problems.

COMMISSIONER GIBSON: You call this government

DR. HOLTROP: I would call the whole thing government monetary policy, yes -- monetary policy as applied by the government -- but it falls into these two things, because in economic theory it is often said -- and we have been faced with that situation in Holland also, where our professors of economics insisted that the government should in its own expenditure policies compensate the fluctuations in the private sector, so that in a period of boom the government should spend less and in a period of depression the government should spend more. If you come to the actual experience of these things, it appears to be relatively easy to spend more in times of depression, but it is quite a job for government to spend less in times of boom. After all, one has to realize that a large part of government expenditure is accessory to the expenditure of the private sector. If the infrastructure of the economy has to be taken care of by the government, you cannot say, in a five-year period of upward cycle, "I am not going to build roads; I am not going to build harbours; I am not going to build hospitals" -- et cetera. In that sense, the whole idea that the government could just compensate fluctuations in expenditure by the private sector is, in my opinion, an exaggerated notion of the possibilities of compensatory action by the government. The government is also a going concern. Indeed, we must strive for governments not exaggerating the boom and not themselves blowing themselves up in the upward

MR. [illegible]: I would call the whole thing government monetary policy, yes -- monetary policy as applied by the government -- but it falls into these two things, because in economic theory it is often said -- and we have been faced with that situation in Holland also, where our professors of economics insisted that the government should in its own expenditure policies compensate the fluctuations in the private sector, so that in a period of boom the government should spend less and in a period of depression the government should spend more. If you come to the actual experience of these things, it appears to be relatively easy to spend more in times of depression, but it is quite a job for government to spend less in times of boom. After all, one has to realize that a large part of government expenditure is accessory to the expenditure of the private sector. If the infra-structure of the economy has to be taken care of by the government, you cannot say, in a five-year period of upward cycle, "I am not going to build roads; I am not going to build harbours; I am not going to build hospitals" -- et cetera. In that sense, the whole idea that the government could just compensate fluctuations in expenditure by the private sector is, in my opinion, an exaggerated notion of the possibilities of compensatory action by the government. The government is also a going concern. Indeed, we must strive for governments not exaggerating the boom and not themselves blowing themselves up in the upward

cycle and shrinking in the downward. But to expect them to do the reverse is too much.

In the choice of ways of financing it is, however, indeed possible that in the boom they concentrate more on the income from taxation and borrowing in the long term market, even if they have to compete with the private sector and pay a somewhat higher rate of interest. In that indirect way they may influence also the possibilities of expenditure by the private sector. That is the importance of debt management. In the way of choosing how to finance the government it plays an important role.

As a matter of fact, we have, in the Netherlands, been applying that policy. In the last few years, for example, operating under the economic impact of what had to be called a kind of imported inflation, the balance of payments surplus coinciding with over-exertion and over-employment in the whole economy, the cry has been that the government should try to compensate for this excess demand. This was not so much done by the reduction of expenditure, but by long term borrowing in the market without these funds being needed for financing, but being used for repayment of short term debt to the banking system, or for repayment of foreign debt. Thus the total amount of liquidity was contracted by internal action, in that way compensating the expansion of liquidity resulting from the balance of payments surplus.

One might, from an internal point of view, argue whether that policy would be conclusive to international equilibrium. It was, however, certainly

cycle and shrinking in the downward. But to expect them to do the reverse is too much.

In the choice of ways of financing it is, however, indeed possible that in the boom they concentrate more on the income from taxation and borrowing in the long term market, even if they have to compete with the private sector and pay a somewhat higher rate of interest. In that indirect way they may influence also the possibilities of expenditure by the private sector. That is the importance of debt management. In the way of choosing how to finance the government it plays an important role.

As a matter of fact, we have, in the Netherlands, been applying that policy. In the last few years, for example, operating under the economic impact of what had to be called a kind of imported inflation, the balance of payments surplus coinciding with over-exertion and over-employment in the whole economy, the cry has been that the government should try to compensate for this excess demand. This was not so much done by the reduction of expenditure, but by long term borrowing in the market without these funds being needed for financing, but being used for repayment of short term debt to the banking system, or for repayment of foreign debt. Thus the total amount of liquidity was contracted by internal action, in that way compensating the expansion of liquidity resulting from the balance of payments surplus.

One might, from an internal point of view, argue whether that policy would be conclusive to inter-

conducive to national equilibrium.

In both of the senses discussed I think that monetary policy of the government is an extremely important factor, and that it is fundamentally a more important factor than the monetary policy of the central bank could be. From a quantitative point of view, the powers and possibilities of government are bigger, in my opinion, than the powers and possibilities of the central bank. So I believe the government can do more there with a positive policy than the central bank on its own can accomplish.

COMMISSIONER GIBSON: Do you regard the co-ordination between government and monetary policy as being of great importance?

DR. HOLTROP: Very important. For a long period already, in the last few years, we have tried continually in Holland to co-ordinate the government policy with central bank policy.

COMMISSIONER GIBSON: How do you co-ordinate them?

DR. HOLTROP: By moving in the same direction. We have been following a restrictive policy in the field of credit expansion while, at the same time, the government has been borrowing in the long term market without needing the funds for expenditure. So their action was positively of a deflationary kind, and ours was of an anti-inflationary kind.

COMMISSIONER GIBSON: Do you meet frequently with the minister of finance?

conducive to national equilibrium.

In both of the senses discussed I think that monetary policy of the government is an extremely important factor, and that it is fundamentally a more important factor than the monetary policy of the central bank could be. From a quantitative point of view, the powers and possibilities of government are bigger, in my opinion, than the powers and possibilities of the central bank. So I believe the government can do more there with a positive policy than the central bank on its own can accomplish.

COMMISSIONER GIBSON: Do you regard the co-ordination between government and monetary policy as being of great importance?

DR. HOLTROP: Very important. For a long period already, in the last few years, we have tried continually in Holland to co-ordinate the government policy with monetary policy.

COMMISSIONER GIBSON: How do you co-ordinate them?

DR. HOLTROP: By moving in the same direction. We have been following a restrictive policy in the field of credit expansion while, at the same time, the government has been borrowing in the long term market without needing the funds for expenditure. So their action was positively of a deflationary kind, and ours was of an anti-inflationary kind.

COMMISSIONER GIBSON: Do you meet frequently with the minister of finance?

DR. HOLTROP: I meet weekly with the minister of finance, so there is a constant exchange of views between the bank and the minister of finance. We feel this is extremely useful. We have followed that tradition already since the whole after-war period. We do it in a very informal way, by meeting on the outskirts of The Hague for luncheon and discussing current problems; and that is my main contact with the minister of finance. Other contacts that take place are on the level sometimes of my colleagues who have to discuss special subjects and als, for example, the contacts about the money market which are being entertained by the responsible higher officials on both sides.

COMMISSIONER HARROLD: In your section on international finance or international liquidity, Dr. Holtrop, you have suggested, in your opinion, there is sufficient international liquidity around, but you say there may be in future some question as to whether there is, and you suggest there are a number of techniques to satisfy anything that might occur. In other words, you suggest a number of alternatives. Would you like to elaborate a little on that as to what can be done about this problem if it arises? For instance, in our case, would you like to comment on the Canadian point of view, if there is some suggestion about lack of liquidity as far as the Canadian situation is concerned in the international market?

DR. HOLTROP: I would not like to go very deeply into this problem of the future of international liquidity because it is a subject on which so much thinking still has to be done. I do not quite see that it could possibly be one of the problems you are closely faced with in this commission. We talk about international liquidity and sufficiency of liquidity. We must then think of whether generally foreign exchange reserves are sufficient for the purposes of the moment. If we come to the conclusion that that generally is so, this, of course, does not imply that necessarily every country has sufficient reserves. There always will be countries that have insufficient reserves, because if they start with sufficient reserves and allow themselves to lose reserves they will end up with insufficient reserves. However, those special situations are never an answer to

[illegible]

...s sufficient international liquidity around, but you say there may be in future some question as to whether there is, and you suggest there are a number of techniques to satisfy anything that might occur. In other words, you suggest a number of alternatives. Would you like to elaborate a little on that as to what can be done about this problem if it arises? For instance, in our case, would you like to comment on the Canadian point of view, if there is some suggestion about lack of liquidity as far as the Canadian situation is concerned in the international market?

DR. HOLTROP: I would not like to go very deeply into this problem of the future of international liquidity because it is a subject on which so much thinking still has to be done. I do not quite see that it could possibly be one of the problems you are closely faced with in this commission. We talk about international liquidity and sufficiency of liquidity. We must then think of whether generally foreign exchange reserves are sufficient for the purposes of the moment. If we come to the conclusion that that generally is so, this, of course, does not imply that necessarily every country has sufficient reserves. There always will be countries that have insufficient reserves, because if they start with sufficient reserves and allow themselves to lose reserves they will end up with insufficient reserves. However, those special situations are never an answer to

the general problem.

On the general problem I am under the impression -- and I have stated it internationally, for example last year at the Vienna meeting of the International Monetary Fund -- that I do not see that there is a general situation -- because that is the important point -- in which countries would be induced to follow deflationary policies because of lack of international reserves. I think it is only a very exceptional condition where that would be the case. From that point, I think general reserves are sufficient, and certainly on the European continent none of the countries at the present moment has insufficient reserves. In the long run the question is, what will be the demand for international reserves? What are really the determinants of international reserves? Really, not much close investigation work has been done on this subject yet. People work on some general notions of reserves having to be equivalent, for example, to four months or six months imports. We do not know sufficiently well, really, what the exigencies of the different countries are. Even so, if it should be true that, indeed, countries want to increase their reserves in proportion to the increase of their national income, then you have one measure of expectation of increase of reserves. You might also say they may want to increase their reserves in proportion to the increase in international trade. That would be another measure of increase. We are not sure whether one or the other prevails. At any rate, this takes a long time, really, before that creates problems. But, conceptually I agree it might create

On the general problem I am under the impression -- and I have stated it internationally, for example last year at the Vienna meeting of the International Monetary Fund -- that I do not see that there is a general situation -- because that is the important point -- in which countries would be induced to follow deflationary policies because of lack of international reserves. I think it is only a very exceptional condition where that would be the case. From that point, I think general reserves are sufficient, and certainly on the European continent none of the countries at the present moment has insufficient reserves. In the long run the question is, what will be the demand for international reserves? What are really the determinants of international reserves? Really, not much close investigation work has been done on this subject yet. People work on some general notions of reserves having to be equivalent, for example, to four months or six months imports. We do not know sufficiently well, really, what the exigencies of the different countries are. Even so, if it should be true that, indeed, countries want to increase their reserves in proportion to the increase of their national income, then you have one measure of expectation of increase of reserves. You might also say they may want to increase their reserves in proportion to the increase in international trade. That would be another measure of increase. We are not sure whether one or the other prevails. At any rate, this takes a long time, really, before that

problems because if we ask how much the gold production is and how great the deficits are which the key currencies will be willing to run -- how big they are -- we have a measure of the possibility of a supply of reserves for the other countries, and then you can come to the conclusion that after five years or ten years, whatever it may be, there may arise a problem. My contention is that it is possible to find solutions for their problems and that there will always be techniques one can think of, and all those sorts of techniques are actually being discussed.

I would prefer not to elaborate on them here because you would not have sufficient time and background to compare the different ones. There have been suggestions of creating these reserves through the International Monetary Fund, or by agreements between the central banks. We have recently been doing that. We have created special reserves in the course of this year in the hands of the International Monetary Fund which have indeed increased the possibilities of the International Monetary Fund to act. These are the additional six billion dollars of resources. We have also had suggestions brought up about the key currency countries holding in the future part of their reserves in the form of other currencies, which would create a different situation from that which we have known in the past.

In all these ways I think solutions can be found for the problems that may present themselves, and I would state that my opinion at this moment is that I do not see there are very urgent problems there, that the international co-operation that has been created already

[illegible] se if we ask how much the gold [illegible] [illegible] [illegible] reserves for the other countries, and then you can come to the conclusion that after five years or ten years, whatever it may be, there may arise a problem. My contention is that it is possible to find solutions for their problems and that there will always be techniques one can think of, and all those sorts of techniques are actually being discussed.

I would prefer not to elaborate on them here because you would not have sufficient time and background to compare the different ones. There have been suggestions of creating these reserves through the International Monetary Fund, or by agreements between the central banks. We have recently been doing that. We have created special reserves in the course of this year in the hands of the International Monetary [illegible] the International Monetary Fund to act. These are the additional six billion dollars of resources. We have also had suggestions brought up about the key currency countries holding in the future part of their reserves in the form of other currencies, which would create a different situation from that which we have known in the past.

In all these ways I think solutions can be found for the problems that may present themselves, and I would state that my opinion at this moment is that I do not see there are very urgent problems there, that the international co-operation that has been created already

at the present time does sufficiently take care of the problems which we are apt to face in the near future, and that we must continue to study all the possibilities of elaborating this co-operation to be able to face the problems that might present themselves at a later date.

COMMISSIONER GIBSON: Dr. Holtrop, you have made it quite clear that you put a high priority on exchange stability. As you are aware, in this country we have had a flexible exchange rate up until recently, beginning in 1950 and running until very recently.

DR. HOLTROP: Yes.

COMMISSIONER GIBSON: For rather special reasons, partly connected with our vulnerability to large capital movements. Would you care to say anything about flexible exchange rates -- whether you see any place for them in special circumstances; whether in a country like Canada flexibility within certain limits might be reasonable?

DR. HOLTROP: I would like to put it this way: fundamentally I am thinking in terms of fixed exchange rates, and I do so perhaps with the bias of a relatively small European country, neighbour to many other relatively small and some larger European countries with a high degree of integration of trade and commerce which would be simply inconceivable to maintain in a system of fluctuating rates. You could not have that high degree of integration which we have in Europe if all the competitive relationships might be influenced any day by fluctuations in the rate of

at the present time does sufficiently take care of the problems which we are apt to face in the near future, and that we must continue to study all the [illegible] at a later date.

COMMISSIONER GIBSON: Dr. Holtrop, you have made it quite clear that you put a high priority on exchange stability. As you are aware, in this country we have had a flexible exchange rate up until recently, beginning in 1950 and running until very recently.

DR. HOLTROP: Yes.

COMMISSIONER GIBSON: For rather special reasons, partly connected with our vulnerability to large capital movements. Would you care to say anything about flexible exchange rates -- whether you see any place for them in special circumstances; whether in a country like Canada flexibility within certain limits might be reasonable?

DR. HOLTROP: I would like to put it this way: fundamentally I am thinking in terms of fixed exchange rates, and I do so perhaps with the bias of a relatively small European country, neighbour to many other relatively small and some larger European countries with a high degree of integration of trade and commerce which would be simply inconceivable to maintain in a system of fluctuating rates. You could [illegible] be influenced any day by fluctuations in the rate of

exchange. From that point of view, I might say as a small European country I hardly can think in other terms than in terms of a fixed rate of exchange, and if you have not got a fixed rate of exchange by international agreement you would probably have one because in the case of fluctuating rates you would as soon as possible try to attach yourself to a fixed rate with one of the big neighbours in which you had confidence that the rate they maintained would be a rate based on policies of fundamental equilibria.

I hesitate to express myself on the Canadian case because I simply do not know enough about it. I have some general knowledge, of course, of the very special conditions in which Canada is situated. I do have an understanding, therefore, of the difficulties. I have looked upon the fluctuating rate as an exception which the International Monetary Fund and the international world has accepted. You have, nevertheless, maintained a rather stable rate almost like a fixed parity, and recently you have come into developments which have led to a change in this rate, and finally to the decision also to get back to a fixed rate. So, at the present moment you find yourselves back into a fixed rate.

We mentioned this morning the fixed rate: the fixed rate system, as we know it in the International Monetary Fund. This system has a strong bias for maintaining the rate, but it does not exclude a change of rate, and the system of Bretton Woods is that in the case of fundamental disequilibrium it is admissible to change the rate. On the other hand, our experience has shown

exchange. From that point of view, I might say as a [illegible] terms than in terms of a fixed rate of exchange, and if you have not got a fixed rate of exchange by international agreement you would probably have one because in the case of fluctuating rates you would as soon as possible try to attach yourself to a fixed rate with one of the big neighbours in which you had confidence that the rate they maintained would be a rate based on policies of fundamental equilibria.

I hesitate to express myself on the Canadian case because I simply do not know enough about it. I have some general knowledge, of course, of the very special conditions in which Canada is situated. I do have an understanding, therefore, of the difficulties. I have looked upon the fluctuating rate as an exception which the International Monetary Fund and the international world has accepted. You have, nevertheless, maintained a rather stable rate almost like a fixed parity, and recently you have come into developments which have led to a change in this rate, and finally to the decision also to get back to a fixed rate. So, at the present moment you find yourselves back into a fixed rate.

We mentioned this morning the fixed rate: the fixed rate system, as we know it in the International Monetary Fund. This system has a strong bias for maintaining the rate, but it does not exclude a change of rate, and the system of Bretton Woods is that in the case of fundamental disequilibrium it is admissible to change the rate. On the other hand, our experience has shown

how difficult it is to take that sort of decision and how much that sort of decision -- even if based on what you might call fundamental disequilibria -- leads to reverberations and to speculative movements and expectations.

So, fundamentally, we must try to have, I think, fixed rates of exchange and adapt our economies to that fixed rate. But, I do admit that there may be very special conditions where it becomes extremely difficult and where special problems arise.

I do see in your case, on the one hand, the factor of the enormous influence of that one big neighbour. We have also big neighbours; we have three of them. The conditions in the three of them will not be exactly the same at the same moment. There are compensating factors in it, and that will tend to make our problems somewhat easier.

COMMISSIONER GIBSON: There is a tremendous amount of capital which may move either way at any moment?

DR. HOLTROP: Yes, I understand that.

COMMISSIONER GIBSON: It is not just the concern of the rate being too high, as it was a while ago, but sometimes the forces tend to push our exchange rate the other way.

DR. HOLTROP: Yes.

COMMISSIONER MACKINTOSH: Would your big Netherlands investors, institutional and individual,

be shifting funds in and out of French, Belgian and German securities?

DR. HOLTROP: We still operate under a system of foreign exchange controls for capital movements in Holland. So, we have completely liberalized current movements, but for capital movements we have not yet re-established complete freedom. That is to say, we allow free movements of capital in the stock exchange, and we allow free movement of entrepreneurial capital, but we have not, for example, free movement of short-term capital for corporations. So, Dutch corporations cannot just shift liquidity from Holland to another country. They have to apply for a license if they want to hold part of their liquid means in another country. Therefore, we have not the possibility of sudden movements. As I say, in the stock exchange we have free movement, but there we have still, theoretically at any rate, the possibility of a double rate. You are familiar with that system: you know the notion of security sterling. As a matter of principle, we still know the security guilder. For several years it has been at par with the commercial rate and it has almost become only a theoretical possibility that you might let the rate go, but it is a fact that at the present moment we still have the situation that if suddenly there was an enormous demand from the Dutch to buy American securities, or an enormous movement for foreigners to liquidate Dutch securities they are holding, we might at such a moment let the security rate separate from the commercial rate.

ing funds in and out of French, Belgian

...ilities.

DR. HOLTROP: We still operate under a system of foreign exchange controls for capital movements in Holland. So, we have completely liberalized current movements, but for capital movements we have not yet re-established complete freedom. That is to say, we allow free movements of capital in the stock exchange, and we allow free movement of entrepreneurial capital, but we have not, for example, free movement of short-term capital for corporations. So, Dutch corporations cannot just shift liquidity from Holland to another country. They have to apply for a license if they want to hold part of their liquid means in another country. Therefore, we have not the possibility of sudden movements. As I say, in the stock exchange we have free movement, but there we have still, theoretically at any rate, the possibility of a double rate. You are familiar with that system: you know the notion of security sterling. As a matter of principle, we still know the security guilder. For several years it has been at par with the commercial rate and it has almost become only a theoretical possibility that you might let the rate go, but it is a fact that at the present moment we still have the situation that if suddenly there was an enormous demand from the Dutch to buy American securities, or an enormous movement for foreigners to liquidate Dutch securities they are holding, we might at such a moment t the security rate separate from the commercial rate.

But, as I say, it has gradually become a theoretical condition, though it is still there.

The answer is that we have not been worried by very big capital movements in the shifting of Dutch capital to other countries. We have, in a way, been somewhat worried by the shifting of foreign capital to the Dutch market. We have, in a way, been exporting securities to a very high extent, and therefore have also, in a smaller way than you, the problem of capital imports which have exceeded our real demands for capital. So, the influx of capital in the form of foreign buying of Dutch securities has given rise to some thinking about this problem, but we have not taken any measures against it. This present year it has been somewhat lower than the year before, but these have been movements that were in the magnitude of up to one billion guilders a year, and that is quite a lot of money for a country with a national income of 40 billion guilders. It is 2½ per cent of national income, which is comparable to the movement you have experienced yourselves. That type of movement can give rise to problems.

We have found a compensation also by the big export of capital, and we have intermittently allowed foreign borrowing in the Dutch market to make possible also a certain additional outflow of funds. Last year we had foreign borrowing to an amount of 400 million guilders. So far this year we have allowed foreign issues on the Dutch market in the amount of 150 million guilders. So, that is a kind of compensating movement.

[illegible]

The answer is that we have not been worried by very big capital movements in the shifting of Dutch capital to other countries. We have, in a way, been somewhat worried by the shifting of foreign capital to the Dutch market. We have, in a way, been exporting securities to a very high extent, and therefore have also, in a smaller way than you, the problem of capital imports which have exceeded our real demands for capital. So, the influx of capital in the form of foreign buying of Dutch securities has given rise to some thinking about this problem, but we have not taken any measures against it. This present year it has been somewhat lower than the year before, but these have been movements that were in the magnitude of up to one billion guilders a year, and that is quite a lot of money for a country with a national income of 40 billion guilders. It is $2\frac{1}{2}$ per cent of national income, which is comparable to the movement you have experienced yourselves. That type of movement can give rise to problems.

We have found a compensation also by the big export of capital, and we have intermittently allowed foreign borrowing in the Dutch market to make possible also a certain additional outflow of funds. Last year we had foreign borrowing to an amount of 400 million guilders. So far this year we have allowed foreign [illegible] guilders. So, that is a kind of compensating movement.

COMMISSIONER BROWN: You have no controls over the servicing of foreign capital that comes into the country?

DR. HOLTROP: How do you mean?

COMMISSIONER MACKINTOSH: Payment of interest?

DR. HOLTROP: Oh,no; that is completely free because that is current payments, of course, yes.

THE CHAIRMAN: I wish to thank you, Dr. Holtrop, for your very impressive contribution to our studies. I know I express the view of all present that today we have witnessed a brilliant performance.

DR. HOLTROP: They are very kind words, Mr. Chairman. I want to assure you it has been a pleasure to have this exchange of views.

THE CHAIRMAN: We shall adjourn now until 9.15 tomorrow morning when we shall hear the submission of Professor Lundberg.

--- Adjournment.

Royal Commission on Banking and Finance

DR. MARIUS W. HOLTROP

Hearings held at

OTTAWA

Vol.

28A

Date.

SEPT. 11, 1962

Official Reporters
F.J.Nethercut and R.J.Young
Toronto, Ont.

Memorandum of evidence submitted by Dr. Marius W. Holtrop, President of De Nederlandsche Bank N.V., Chairman of the Board of Directors and President of the Bank for International Settlements, to the Royal Commission on Banking and Finance

Question 1:

Could you tell us what you believe to be the objectives of monetary policy, and how you believe these objectives are related to the goals of other economic and financial policy?

The objectives of monetary policy

(1) The primary objective of monetary policy is, in my opinion, to maintain, under conditions of reasonably full employment, the internal and the external value of the monetary unit, or, in other words, the stability of the price level and the stability of the rate of exchange.

(2) The twofold objective, thus stated, implies one of the important dilemmas of monetary policy: the possibility of authorities having to choose between giving priority to either part of the objective.

Actually, the simultaneous realization of stability of prices and of stability of exchange rates is possible only under conditions of neutrality in the outside world, and even then may run into snags. If these conditions of neutrality do not exist and if a country has to face inflationary or deflationary pressures, coming from abroad, monetary authorities cannot, in the long run, escape the choice of giving precedence to either internal or external stability.

No a priori rule can be given as to which of the two should prevail.

(3) Another potential dilemma of monetary policy lies hidden in the presupposition of the existence of a situation of reasonably full employment.

If such a situation does not exist this may have been caused by failure or deficiency of monetary policies in the past. If so, it is likely that a constructive monetary policy can restore full employment without compromising the stated primary objective of monetary policy. It is also possible, however, that the situation of under-employment is due to external causes, or to internal policy mistakes in other fields than the monetary one. In such a case using monetary policy to try to restore full employment may very well lead to a clash with the primary objective of price stability and exchange stability.

It is for this reason that I do not include the attainment and the maintenance of full employment among the primary objectives of monetary policy though they must, of course, be considered among the foremost objectives of economic policy generally. From the strictly monetary point of view, full employment has to be considered as a secondary objective, that, generally, ought to be pursued by monetary means only within the limits set by the primary one.

Before reverting to the problem of the relationship between aims of policy and instruments of policy, I should like first to discuss the essential characteristics of monetary policy.

lies hidden in the presupposition of the existence of a situation of reasonably full employment.

If such a situation does not exist this may have been caused by failure or deficiency of monetary policies in the past. If so, it is likely that a constructive monetary policy can restore full employment without comprmising the stated primary objective of monetary policy. It is also possible, however, that the situation of under-employment is due to external causes, or to internal policy mistakes in other fields than the monetary one. In such a case using monetary policy to try to restore full employment may very well lead to a clash with the primary objective of price stability and exchange stability.

It is for this reason that I do not include the attainment and the maintenance of full employment among the primary objectives of monetary policy though they must, of course, be considered among the foremost objectives of economic policy generally. From the strictly monetary point of view, full employment has to be considered as a secondary objective, that, generally, ought to be pursued by monetary means only within the limits set by the primary one.

Before reverting to the problem of the relationship between aims of policy and instruments of policy, I should like first to discuss the essential characteristics of monetary policy.

The essential characteristics of monetary policy

(4) Monetary policy consists essentially in the act of exerting an influence on the present and future volume of total national expenditure, by way of controlling the creation of liquidity, i.e. the creation of money (primary liquidity) and of near-money (secondary liquidity).

An important subordinate function consists in influencing the net import or export of capital by manipulation of the rate of interest.

(5) In order to prevent an inflationary excess of total expenditure - which would lead to overemployment and an upward pressure on prices, and to a balance of payments deficit, which would in the long run endanger exchange stability - as well as a deflationary deficiency of total expenditure - which would lead to underemployment, to a downward pressure on prices and to a balance of payment surplus - monetary policy must strive at maintaining the flow of total expenditure at an optimum level.

To fulfill equilibrium conditions this level should be such that the part of total expenditure spent abroad will equal foreign demand on the home market, increased by net capital imports, and that the part spent internally will just manage to buy sustainable output at current prices, less exports. Thus price stability, balance of payments equilibrium and therefore exchange stability, and full employment will simultaneously be assured.

The essential characteristics of monetary policy

(4) Monetary policy consists essentially in the act of exerting an influence on the present and future volume of total national expenditure, by way of controlling the creation of liquidity, i.e. the creation of money (primary liquidity) and of near-money (secondary liquidity).

An important subordinate function consists in influencing the net import or export of capital by manipulation of the rate of interest.

(5) In order to prevent an inflationary excess of total expenditure - which would lead to overemployment and an upward pressure on prices, and to a balance of payments deficit, which would in the long run endanger exchange stability - as well as a deflationary deficiency of total expenditure - which would lead to underemployment, to a downward pressure on prices and to a balance of payment surplus - monetary policy must strive at maintaining the flow of total expenditure at an optimum level.

To fulfill equilibrium conditions this level should be such that the part of total expenditure spent abroad will equal foreign demand on the home market, increased by net capital imports, and that the part spent internally will just manage to buy sustainable output at current prices, less exports. Thus price stability, balance of payments equilibrium and therefore exchange stability, and full employment will simultaneously be assured.

(6) The dilemmas of monetary policy, which I already mentioned, result from the fact that not one and the same level of total expenditure may satisfy all the conditions just set forth.

The level of total expenditure, the domestic part of which will just buy sustainable output less exports, may induce a level of imports that exceeds the sum total of exports and net capital imports (or the amount of exports less net capital exports, as the case may be) and may thus lead to a balance of payments deficit. The lower level of total expenditure that will reduce imports to the sum of exports and net capital imports may not satisfy the condition of full employment. Increasing the level of exports may require a lower level of cost that cannot be induced by monetary policy. Increasing net capital imports may be possible by increasing interest rates but may, in the long run, create balance of payments difficulties by the burden of debt service.

Thus we must conclude that, though it is easy to define the ideal set of equilibrium conditions, reality will force monetary policy, even strictly within the limits of its own objectives, to aim at compromise.

The techniques of monetary policy

(7) The techniques available to monetary policy in aiming at maintaining the conditions of full internal and external equilibrium described in sub (5) consist in:

(a) regulating quantitatively the creation of money, and to a certain extent also of near-money, with the purpose of directly influencing the volume of total expenditure;

(b) manipulating the level of interest rates, or the relationship between short term and long term rates, particularly by working on the short term rate, with the purpose of:

(i) influencing the public's and the business community's propensity to spend, with the purpose of thus indirectly influencing the volume of total expenditure;

(ii) influencing ways of financing, both active and passive, i.e. the choices between borrowing long term or short term, and between lending, respectively investing, long term or short term, with the purpose of thus influencing the volume of liquid wealth held in the form of money and near-money;

(iii) influencing the net import or the net export of capital,so as to buffer the balance of payments consequences of changes in the propensity to import and/or changes in the demand for exports.

(8) In regulating the creation of money and near-money the aim of monetary policy - unless considerations of external equilibrium should intervene - must be to allow the creation of a sufficient volume of money and near-money to compensate the net loss of expenditure that will result from the joint effect of:

(a) regulating quantitatively the creation of money, and to a certain extent also of near-money, with the purpose of directly influencing the volume of total expenditure;

(b) manipulating the level of interest rates, or the relationship between short term and long term rates, particularly by working on the short term rate, with the purpose of:

(i) influencing the public's and the business community's propensity to spend, with the purpose of thus indirectly influencing the volume of total expenditure;

(ii) influencing ways of financing, both active and passive, i.e. the choices between borrowing long term or short term, and between lending, respectively investing, long term or short term, with the purpose of thus influencing the volume of liquid wealth held in the form of money and near-money;

(iii) influencing the net import or the net export of capital, so as to buffer the balance of payments consequences of changes in the propensity to import and/or changes in the demand for exports.

(8) In regulating the creation of money and near-money the aim of monetary policy - unless considerations of external equilibrium should intervene - must be to allow the creation of a sufficient volume of money and near-money to compensate the net loss of expenditure that will result from the joint effect of:

(a) the spontaneous additions, held back out of the current flow of income, to the average stock of money and near-money, held by the public and the business community, that will necessarily accompany any growth of real income;

(b) the spontaneous additions to the liquid holdings of the public and the business community that will result from any drop in the economy's propensity to spend;

(c) the spontaneous withdrawals out of the liquid holdings of the public and the business community, to finance additional expenditure, that will result from any increase in the economy's propensity to spend.

(9) Though one may thus, conceptually, nicely define how monetary policy ought to exactly compensate the fluctuations in effective demand which are due to the possibility of hoarding and dishoarding money, it actually is impossible to closely observe these fluctuations. Monetary policy must therefore rely on indirect indications to judge the adequacy of current money creation. It therefore can, at its very best, only approximately succeed to maintain the flow of total expenditure at its optimum level. Fluctuations in induced investment, i.e. in inventories, in foreign exchange reserves and in actual production, will buffer the impact of fluctuations in total expenditure that monetary policy has been unable to prevent.

(10) Apart from the creation of money by external causes through balance of payments surplus - or cancellation through deficit - the actual internal creation

(a) the spontaneous additions, held back out of the current flow of income, to the average stock of money and near-money, held by the public and the business community, that will necessarily accompany any growth of real income;

(b) the spontaneous additions to the liquid holdings of the public and the business community that will result from any drop in the economy's propensity to spend;

(c) the spontaneous withdrawals out of the liquid holdings of the public and the business community, to finance additional expenditure, that will result from any increase in the economy's propensity to spend.

(9) Though one may thus, conceptually, nicely define how monetary policy ought to exactly compensate the fluctuations in effective demand which are due to the possibility of hoarding and dishoarding money, it actually is impossible to closely observe these fluctuations. Monetary policy must therefore rely on indirect indications to judge the adequacy of current money creation. It therefore can, at its very best, only approximately succeed to maintain the flow of total expenditure at its optimum level. Fluctuations in induced investment, i.e. in inventories, in foreign exchange reserves and in actual production, will buffer the impact of fluctuations in total expenditure that monetary policy has been unable to prevent.

(10) Apart from the creation of money by external causes through balance of payments surplus - or cancellation through deficit - the actual internal creation

of money and of near-money will, generally, take place by the private banking system and, possibly, by other deposit-taking institutions, by way of financing some part of the expenditure of the private or the public sector out of deposits with a money - or a near-money-character.

Money creation may, however, also take the form of direct recourse by the Government to the central bank or to the money market. Recourse to the Bank would, of course, mean actual creation of money. Recourse to the money market might mean money creation if the banking system were taking the paper; it would mean creation of near-money if the paper were taken by the public.

(11) The power of monetary authorities to regulate the creation of money and of near-money depends largely on their power to control, by direct or indirect means, the credit- and investment - policies of the money-creating institutions. This power of control is generally vested in the central bank.

By taking direct recourse to the money-market Government can however, also exercise a direct influence on the process of creation of money and near-money. Likewise important is the power of Government to exert a contrary influence, namely that of cancelling money. It can do so by accumulating surplus out of current income and using such surplus to repay debt to the central bank or the banking system. It can do the same by borrowing on the capital market in excess of financing requirements.

of money and of near-money will, generally, take place by the private banking system and, possibly, by other deposit-taking institutions, by way of financing some part of the expenditure of the private or the public sector out of deposits with a money - or a near-money-character.

Money creation may, however, also take the form of direct recourse by the Government to the central bank or to the money market. Recourse to the Bank would, of course, mean actual creation of money. Recourse to the money market might mean money creation if the banking system were taking the paper; it would mean creation of near-money if the paper were taken by the public.

(ii) The power of monetary authorities to regulate the creation of money and of near-money depends largely on their power to control, by direct or indirect means, the credit- and investment - policies of the money-creating institutions. This power of control is generally vested in the central bank.

By taking direct recourse to the money-market Government can however, also exercise a direct influence on the process of creation of money and near-money. Likewise important is the power of Government to exert a contrary influence, namely that of cancelling money. It can do so by accumulating surplus out of current income and using such surplus to repay debt to the central bank or the banking system. It can do the same by borrowing on the capital market in excess of financing requirements.

(12) It follows that monetary policy does not consist of central bank policy only. It includes that part of budgetary policy which is concerned with the choice between the financing of Government expenditure, in excess of income, from taxation, out of capital market- or out of money market-resources. It also includes that part of debt management policy which is concerned with the choice between consolidation or deconsolidation of outstanding debt.

Consequently the responsibility for monetary policy cannot be considered to be a responsibility of the central bank only. The responsibility of Government will always be involved, also in those cases where the Government does not share in ultimate responsibility for central bank policy proper.

(13) The possibility for monetary authorities to manipulate to a certain extent the rate of interest, as mentioned sub (7,b), is based on:

(a) the power of the central bank to fix the rate at which it is willing to make its own credit available to the market;

(b) the influence the central bank may exert on market conditions by its open market policies;

(c) the influence the Government may exert on market conditions as one of the principal borrowers.

(14) Manipulation of the rate of interest can be expected to influence the present or future volume of total expenditure in so far as:

(12) It follows that monetary policy does not consist of central bank policy only. It includes that part of budgetary policy which is concerned with the choice between the financing of Government expenditure, in excess of income, from taxation, out of capital market- or out of money market-resources. It also includes that part of debt management policy which is concerned with the choice between consolidation or deconsolidation of outstanding debt.

Consequently the responsibility for monetary policy cannot be considered to be a responsibility of the central bank only. The responsibility of Government will always be involved, also in those cases where the Government does not share in ultimate responsibility for central bank policy proper.

(13) The possibility for monetary authorities to manipulate to a certain extent the rate of interest, as mentioned sub (7.b), is based on:

(a) the power of the central bank to fix the rate at which it is willing to make its own credit available to the market;

(b) the influence the central bank may exert on market conditions by its open market policies;

(c) the influence the Government may exert on market conditions as one of the principal borrowers.

(14) Manipulation of the rate of interest can be expected to influence the present or future volume of total expenditure in so far as:

(a) higher short term rates will tend to lessen demand for bank loans;

(b) higher long term rates may cause certain investment projects to become unattractive;

(c) higher long term rates will depress capital values and may for this and other reasons lessen the propensity to spend.

Lower rates can be expected to have an opposite influence. On the other hand it has to be taken into account that:

(d) higher short term rates will cause shifts from money holdings to near-money holdings, which may increase opportunities for financing additional expenditure;

(e) higher rates generally, will tend to attract foreign short term and long term capital, which will increase opportunities for financing expenditure while, at the same time, improving the balance of payments.

(15) The countereffects sub (d) and (e) lessen the usefulness of the rate of interest as an instrument of monetary policy, except that the combination of the effects sub (a) to (c) with the balance of payments effect sub (e) may precisely be desired.

(16) The fact that the restrictive effect on total expenditure of an increase in the rate of interest may be doubtful does not mean that in case of a tendency to over-expenditure an increase of interest rates could be avoided. If monetary authorities by quantitative

[illegible]

(b) higher long term rates may cause certain investment projects to become unattractive;

[illegible] capital values and may for this and other reasons lessen the propensity to spend.

Lower rates can be expected to have an opposite influence. On the other hand it has to be [illegible]

(d) higher short term rates will cause shifts from money holdings to near-money holdings, which may increase opportunities for financing additional expenditure;

(e) higher rates generally, will tend to attract foreign short term and long term capital, which [illegible] while, at the same time, improving the balance of payments.

(15) The countereffects sub (d) and (e) lessen the usefulness of the rate of interest as an instrument of monetary policy, except that the combination of the effects sub (a) to (c) with the balance of payments effect sub (e) may precisely be desired.

(16) The fact that the restrictive effect on total expenditure of an increase in the rate of interest may be doubtful does not mean that in case of a tendency to over-expenditure an increase of interest rates could be avoided. If monetary authorities by quantitative

measures put a limit to the possibilities of inflationary financing, the excessive demand for credit is bound to lead to a rise in interest rates.

Such rise, which could only be avoided by satisfying the excessive demand for credit, should not be confounded with the rise of interest rate induced by way of policy measure. It would be none but the unavoidable consequence of market conditions.

The relationship between monetary policy and other instruments of policy

(17) Having set forth what I believe to be the main objectives and the main implements of monetary policy, I may now revert to the question of the relationship between the aims of monetary policy and those of other economic and financial policies.

The aims of general economic policy comprise a large number of subjects, partly economic or social goals in themselves, partly conditions considered to be essential for the proper fulfilment of the ultimate goals. Among the ultimate goals I would mention in the very first place the maximalization of wealth, a goal that comprises the secondary goals of full employment and satisfactory growth. The latter subject brings in the problem of choice between maximalization of present or of future wealth, clearly a problem with partly political aspects. Among the ultimate goals one may also reckon a fair distribution of income, a harmonious occupational distribution, a larger or smaller degree of collective provision and of public ownership, and other desiderata of a social-political character on which

[illegible]
[illegible] lead to a rise in interest rates.

Such rise, which could only be avoided by satisfying the excessive demand for credit, should not be confounded with the rise of interest rate induced by way of policy measure. It would be none but the unavoidable consequence of market conditions.

<u>The relationship between monetary policy and other instruments of policy</u>

(17) Having set forth what I believe to be the main objectives and the main implements of monetary policy, I may now revert to the question of the relationship between the aims of monetary policy and those of other economic and financial policies.

The aims of general economic policy comprise a large number of subjects, partly economic or social goals in themselves, partly conditions considered to be essential for the proper fulfillment of the ultimate goals. Among the ultimate goals I would mention in the very first place the maximalisation of wealth, a goal that comprises the secondary goals of full employment and satisfactory growth. The latter subject brings in the problem of choice between maximalization of present or of future wealth, clearly a problem with partly political aspects. Among the ultimate goals one may also reckon a fair distribution of income, a harmonious occupational distribution, a larger or smaller degree of collective provision and of public ownership, and other desiderata of a social-political character on which

differences of opinion are obviously possible.

Not among the ultimate goals, but among the conditions considered to be essential for their fulfilment, we find the double objective of monetary policy, viz. the maintaining of the stability of prices and of the equilibrium of the balance of payments.

(18) It is exactly this fact, that the main objective of monetary policy is the establishment and maintenance of conditions that are in the long run essential to any economic system and that are neutral in respect to the pursuit of any of the possible ultimate goals of social-economic policies, that sets monetary policy apart from other instruments of policy, such as budgetary and fiscal policy, wage and price policy, foreign trade and agricultural policies, and others. Most of these other instruments of policy either affect the distribution of income or the direction of expenditure. It is monetary policy alone, that is interested in the level of income and expenditure only, and not in its composition. This is, no doubt, the reason why, to such a large extent, the management of monetary policy can be delegated to a non-political authority: the central bank.

Of course this does not mean that in the short run the objectives of monetary policy may not occasionally come into conflict with other political aims. We will have the opportunity to discuss examples later. It does mean, however, that in the long run the objectives of monetary policy, just because of their neutrality in respect to other aims, will have to prevail.

Not among the ultimate goals, but among the conditions considered to be essential for their fulfilment, we find the double objective of monetary policy, viz. the maintaining of the stability of prices and of the equilibrium of the balance of payments.

(13) It is exactly this fact, that the main objective of monetary policy is the establishment and maintenance of conditions that are in the long run essential to any economic system and that are neutral in respect to the pursuit of any of the possible ultimate goals of social-economic policies, that sets monetary policy apart from other instruments of policy, such as budgetary and fiscal policy, wage and price policy, foreign trade and agricultural policies, and others. Most of these other instruments of policy either affect the distribution of income or the direction of expenditures. It is monetary policy alone that is interested in the level of income and expenditure only, and not in its composition. This is, no doubt, the reason why, to such a large extent, the management of monetary policy can be delegated to a non-political authority: the central bank.

Of course this does not mean that in the short run the objectives of monetary policy may not occasionally come into conflict with other political [illegible] [illegible] objectives of monetary policy, just because of their neutrality in respect to other aims, will have to [illegible]

(19) A word might be said, in this connection, about the relationship between monetary policy and growth. The determinants of growth are still somewhat controversial. Underemployed resources, level of education, organizational capacity, industrial know-how, saving and investment, they all have to play their role. There is nothing monetary policy can add to these conditions. But it is all important that once the process of growth has started monetary policy should take care that the internal creation of money will be sufficient to satisfy the growing cash requirements that will be induced by the rise of real income. If not, these requirements will have to be met out of balance of payments surplus, which may cause a disturbance of international relations, or, if conditions do not allow for a surplus, the lack of response of the monetary sector will constitute a drag on potential growth.

(9) A word might be said, in this connection about the relationship between monetary policy and growth. The determinants of growth are still somewhat contro- [illegible]. Underemployed resources, level of education, [illegible] [illegible]. There is nothing monetary policy can add to these conditions. But it is all important that once the process of growth has started monetary policy should take care that the internal creation of money will be sufficient to satisfy the growing cash requirements that will be induced by the rise of real income. If not, these requirements will have to be met out of balance of payments surplus, which may cause a disturbance of international relations, or, if conditions do not allow for a surplus, the lack of response of the monetary sector will constitute a drag on potential growth.

Question 2:

What methods does your bank employ to judge the appropriateness of its monetary policy in prevailing economic and financial circumstances?

The indicators of desirable monetary action

(20) It should be stated at the outset that there exist long periods during which monetary policy generally, and central bank policy particularly, do not need to be spectacularly active because deviations from the ideal situation of reasonable stability of prices, balance of payments equilibrium and reasonably full employment are not of such a magnitude that corrective monetary measures seem to be indicated. During such periods monetary policy can limit itself to taking care that no developments occur that might impede the control of future disturbances.

(21) Circumstances in which corrective monetary action is clearly indicated are:

(a) periods of boom and overemployment, of rising costs and rising prices, during which the balance of payments shows a deficit;

(b) periods of recession and underemployment, during which the balance of payments position is satisfactory.

Circumstances, on the other hand, in which, even though action might be indicated, monetary policy is faced with serious dilemmas are:

(c) periods of boom and over-employment, during which the balance of payments shows important surplus, or at least, is not unsatisfactory;

(d) periods in which recession and under-employment coincide with balance of payments deficits.

(22) The Netherlands went through experience (a) during the Korea-boom of 1950 to early 1951, and again in the period 1956 to early 1957. They went through experience (b) in 1952, and to some extent in 1958. They finally lived through a rather prolonged period of experience (c) during the years 1960 to 1962. They never found themselves, since the last war, in position (d).

(23) In the periods mentioned above central bank policy has always been of an anti-cyclical character. In the periods 1950/51, 1956/57 and 1961/62 credit restrictive measures were taken and the Bank's discount rate was increased. In the years 1952 and 1958 restrictive measures were discontinued and the bank rate was reduced. The Government took strong compensatory actions in the years of foreign exchange crisis 1951 and 1957. Programmes of retrenchment of expenditure and increase of taxation, designed to stop inflationary developments that had occurred in the years before, were introduced in both years. Though highly effective in the years of introduction, it cannot be denied that these programmes by their after-effects added to the recessive tendencies that prevailed in the years 1952 and 1958. A compensatory monetary policy was also followed by the Government in the years 1960 to 1962, not, however, by cutting expenditure, but by delaying planned reduction of taxation and by long term borrowing in the capital

(d) periods in which recession and under-employment coincide with balance of payments deficits.

[illegible] The Netherlands [illegible]

(a) during the Korea-boom of 1950 to early 1951, and again in the period 1956 to early 1957. They went through experience (b) in 1952, and to some extent in 1958. They finally lived through a [illegible] period of experience (c) during the years 1960 to 1962. They never found themselves, since the last war, in position (d).

(25) In the periods mentioned above central bank policy has always been of an anti-cyclical character. In the periods 1950/51, 1956/57 and 1961/62 credit restrictive measures were taken and the Bank's discount rate was increased. In the years 1952 and 1958 restrictive measures were discontinued and the bank rate was reduced. The Government took strong compensatory actions in the years of foreign exchange crisis 1951 and 1957. Programmes of retrenchment of expenditure and increase of taxation, designed to stop inflationary developments that had occurred in the years before, were introduced in both years. Though highly effective in the years of introduction, it cannot be denied that these programmes by their after-effects added to the recessive tendencies that prevailed in the years 1952 and 1958. A compensatory monetary policy was also followed by the Government in the years 1960 to 1962, not, however, by cutting expenditure, but by delaying planned reduction of taxation and by long term borrowing in the capital

market in excess of financing requirements.

(24) In judging the appropriateness and efficacy of its own and of Government's monetary policies the central bank has, of course, to keep in mind the characteristics of the period under review and the limitations hence created to exerting an observable influence on developments.

In the periods clearly indicated for positive monetary action the Bank will turn to the usual monthly indicators of economic behaviour to judge whether developments move into the desired direction. It will especially give attention to (a) industrial production, (b) employment, (c) foreign trade, (d) prices and wages, and finally, to the one indicator that comes available daily: (f) the movement of foreign exchange reserves. On the other hand the Bank will not only look at results, but also at factors that are indicative of direction and force of the monetary influences that are being exerted such as: (g) the course of Government finance, (h) the development of the banking system's loans and investments, and (i) the movement of the rates of interest on money and capital markets. It will, as an indicator of the monetary leeway still available, give attention to (j) the liquidity situation of the banking system and to (k) the volume of liquidity, i.e. of money and near-money available to the economy. Finally, as an important indicator of potential future developments, it will give close attention to (l) the forecasts of the Central Planning Bureau, a Government agency, that has the function of analysing current economic developments,

market in excess of financing requirements.

(24) In judging the appropriateness and efficacy of its own and of Government's monetary policies the central bank has, of course, to keep in mind the characteristics of the period under review and the limitations hence created to exerting an observable influence on developments.

In the periods clearly indicated for positive monetary action the Bank will turn to the usual monthly indicators of economic behaviour to judge whether developments move into the desired direction. It will especially give attention to (a) industrial production, (b) employment, (c) foreign trade, (d) prices and wages, and finally, to the one indicator that comes available daily: (f) the movement of foreign exchange reserves. On the other hand the Bank will not only look at results, but also at factors that are indicative of direction and force of the monetary influences that are being exerted such as: (g) the course of Government finance, (h) the development of the banking system's loans and investments and (i) the movement in the rates of interest in money and capital markets. It will, as an indicator of the monetary leeway still available, give attention to (j) the liquidity situation of the banking system and to (k) the volume of liquidity, i.e. of money and near-money available to the economy. Finally, as an important indicator of potential future developments, it will give close attention to (l) the forecasts of the Central Planning Bureau, a Government agency, that has the function of analysing current economic developments.

of making estimates of the likely consequences of policy decisions, and of forecasting future developments generally.

(25) In a country like the Netherlands, with a turnover in foreign trade (and services) equal to national income, the balance of payments is a particularly sensitive indicator of internal over- or underexpenditure. The marginal proportion of any increase or decrease of total expenditure that will show up in larger or smaller imports will always be very great.

This situation is very helpful in making monetary policy effective in a period of internal overexpenditure. For the balance of payments deficit that is likely to ensue will drain the liquidity of both the economy itself and of the banking system and will thus tend to strengthen the impact of any restrictive measures taken by the monetary authorities.

(26) A particularly important direct indicator of the efficacy of especially central bank policy is, of course, the development of the banking system's active operations, i.e. of the sum total of its loans and investments, as this magnitude will largely determine the volume of the possible additions to the flow of total expenditure, the control of which is monetary policy's purpose.

In the Netherlands the central bank has, in periods of actual or threatening overexpenditure, set quantitative limits to the expansion of the banking system's loans. Presently, for example, the banks are allowed to increase the volume of their loans by

of making estimates of the likely consequences of policy decisions, and of forecasting future developments generally.

(25) In a country like the Netherlands, with a turnover in foreign trade (and services) equal to national income, the balance of payments is a particularly sensitive indicator of internal over- or underexpenditure. The marginal proportion of any increase or decrease of total expenditure that will show up in larger or smaller imports will always be very great.

This situation is very helpful in making monetary policy effective in a period of internal overexpenditure. For the balance of payments deficit that is likely to ensue will drain the liquidity of both the economy itself and of the banking system and will thus tend to strengthen the impact of any restrictive measures taken by the monetary authorities.

(26) A particularly important direct indicator of the efficacy of especially central bank policy is, of course, the development of the banking system's active operations, i.e. of the sum total of its loans and investments, as this magnitude will largely determin the volume of the possible additions to the flow of total expenditure, the control of which is monetary policy's purpose.

In the Netherlands the central bank has, in periods of actual or threatening overexpenditure, set quantitative limits to the expansion of the banking system's loans. Presently, for example, the banks are allowed to increase the volume of their loans by

not more than one half of one percent per month. In case this percentage is exceeded special non-interest-bearing deposits have to be made with the central bank to the amount of such excess. The extent to which the limits set by the central bank are complied with forms, of course, an important direct measure of the efficacy of the central bank's policy.

(27) A factor which has always had the particular attention of the Bank in judging the efficacy of present policies, but also, and perhaps still more, in gauging the potential threat to future monetary equilibrium, has been the state of liquidity of the economy, as measured by the ratio between the total mass of money and near-money in hands of the public at large and national income.

By near-money, or, to use rather the more specific term, by "secondary liquidity", is meant the sum total of short term claims - other than money proper, i.e. currency and demand deposits subject to check or girotransfer - on the banking system and on the Government, that are being used by the business community as a liquidity reserve. Thus defined secondary liquidity comprises essentially time deposits with the banking system and short term Government paper held outside the banks. The main characteristic of this group of short term money claims is that, in case of massive withdrawal, the claimants can, for all practical purposes, compel the debtors to take recourse to money creation in order to settle their debt. For the banking system this recourse simply takes the form of

not more than one half of one percent per month. In case this percentage is exceeded special non-interest-bearing deposits have to be made with the central bank to the amount of such excess. The extent to which the limits set by the central bank are complied with forms, of course, an important direct measure of the efficacy of the central bank's policy.

(27) A factor which has always had the particular attention of the Bank in judging the efficacy of present policies, but also, and perhaps still more, in gauging the potential threat to future monetary equilibrium, has been the state of liquidity of the economy, as measured by the ratio between the total mass of money and near-money in hands of the public at large and national income.

By near-money, or, to use rather the more specific term, by "secondary liquidity", is meant the sum total of short term claims - other than money proper, i.e. currency and demand deposits subject to check or girotransfer - on the banking system and on the Government, that are being used by the business community as a liquidity reserve. Thus defined secondary liquidity comprises essentially time deposits with the banking system and short term Government paper held outside the banks. The main characteristic of this group of short term money claims is that, in case of massive withdrawal, the claimants can, for all practical purposes, compel the debtors to take recourse to money creation in order to settle their debt. For the banking system this recourse simply takes the form of

crediting sight deposit accounts against debiting time deposits; for the Government it means falling back on the banking system or on the central bank which, under the assumed circumstances, will hardly be able to refuse accommodation. In this respect there exists an essential difference between secondary liquidity and other supposedly liquid claims and assets, which can only be turned into cash in so far as the debtor holds liquid reserves or has the possibility to borrow in the market, or in so far as a substitute holder of the asset can be found.

Experience in the Netherlands has shown that the ratio of money plus secondary liquidity to national income varies within rather narrow limits, though with rising or falling short term interest rates there may be shifts between the proportion of money and of secondary liquidity in the total. Roughly the mass of liquidity amounts to about 45 per cent of national income with money constituting somewhat less than two thirds and secondary liquidity somewhat over one third of the total. In periods of internal overexpenditure and balance of payments deficit the total has gone down to 41 per cent, in periods of recession and/or of balance of payments surplus a ratio as high as 47 per cent has been reached. Higher figures occurred only in the years of repressed inflation of the late forties and in the very early fifties. A high ratio thus gives an indication of the potential loss of foreign exchange that may result from contraction of the mass of liquidity.

It has been the constant policy of monetary authorities in the Netherlands to prevent the mass of

crediting sight deposit accounts against debiting time deposits; for the Government it means falling back on the banking system or on the central bank which, under the assumed circumstances, will hardly be able to refuse accommodation. In this respect there exists an essential difference between secondary liquidity and other [illegible] liquid claims and assets, which can only be turned into cash in so far as the debtor holds liquid reserves or has the possibility to borrow in the market, or in so far as a substitute holder of the asset can be found.

Experience in the Netherlands has shown that the ratio of money plus secondary liquidity to national income varies within rather narrow limits, though with rising or falling short term interest rates there may be shifts between the proportion of money and of secondary liquidity in the total. Roughly the mass of liquidity amounts to about 45 per cent of national income with money constituting somewhat less than two thirds and secondary liquidity somewhat over one third of the total. In periods of internal overexpenditure and balance of payments deficit the total has gone down to 41 per cent, in periods of recession and/or of balance of payments surplus a ratio as high as 47 per cent has been reached. Higher figures occurred only in the years of repressed inflation of the late forties and in the very early fifties. A high ratio thus gives an indication of the potential loss of foreign exchange that may result from contraction of the mass of liquidit

It has been the constant policy of monetary authorities in the Netherlands to prevent the mass of

liquidity to be built up above a reasonable minimum which the economy clearly wishes to hold. For that reason the Government has, in the last decade, in principle abstained from financing any part of budgetary expenditure by short term borrowing, thus leaving the necessary creation of liquidity in proportion to real growth to the banking system's lending to the private sector. It has, moreover, in periods of excess liquidity, as the country has recently experienced in consequence of balance of payments surplus, proceeded to reduce liquidity by borrowing on the long term market for repayment of external debt and for consolidation of internal short term debt held by central bank and banking system.

(28) In view of the specific characteristics attached to the secondary liquidity holdings of the economy the Netherlands Bank considers the financing of expenditure out of creation of secondary liquidity just as much as an inflationary form of financing as its financing out of creaton of money.

It is true that the inflationary effect of such financing, that means its effect on the volume of total expenditure - which effect, according to circumstances ('), may or may not be desired by monetary authorities - may be compensated ad hoc by a spontaneous withdrawal of money out of the current flow of gross income by the business community. Even so, that withdrawal may prove to be of only a temporary nature.

Very easily, however, the addition to the mass of secondary liquidity may come out of the activation

liquidity to be built up above a reasonable minimum which the economy clearly wishes to hold. For that reason the Government has, in the last decade, in principle abstained from financing any part of budgetary expenditure by short term borrowing, thus leaving the necessary creation of liquidity in proportion to real growth to the banking system's lending to the private sector. It has, moreover, in periods of excess liquidity as the country has recently experienced in consequence of balance of payments surplus, proceeded to reduce liquidity by borrowing on the long term market for repayment of external debt and for consolidation of internal short term debt held by central bank and banking system.

(28) In view of the specific characteristics attached to the secondary liquidity holdings of the economy the Netherlands Bank considers the financing of expenditure out of creation of secondary liquidity just as much as an inflationary form of financing as its financing out of creation of money.

It is true that the inflationary effect of such financing, that means its effect on the volume of total expenditure - which effect, according to circumstances (¹), may or may not be desired by monetary authorities - may be compensated ad hoc by a spontaneous withdrawal of money out of the current flow of gross income by the business community. Even so, that withdrawal may prove to be of only a temporary nature.

Very easily, however, the addition to the mass of secondary liquidity may come out of the activation

of existing cash resources, and may then mean an increase in the velocity of circulation of money, with no compensating effect on the volume of total expenditure at all. Or it may enforce a switch from time deposits to sight deposits with the banking system, which would mean a creation of money in which the banking system would only play a passive role.

The Netherlands experienced a bad case of this type of inflationary financing when in 1956/57 the municipalities, finding the capital market exhausted, financed continued investment expenditure by placing short term bills in the money market, which were readily taken by corporate business and financed out of the liquid reserves the latter had been holding with the banking system.

---

(1) The term "inflationary" as used in this connection has therefore no derogatory connotation. It simply means: "increasing the volume of total expenditure".

of existing cash resources, and may then mean an increase in the velocity of circulation of money, with no compensating effect on the volume of total expenditure at all. Or it may enforce a switch from time deposits to sight deposits with the banking system, which would mean a creation of money in which the banking system would only play a passive role.

The Netherlands experienced a bad case of this type of inflationary financing when in 1956/57 the municipalities, finding the capital market exhausted, financed [illegible] expenditure by placing short term bills in the money market, which were readily taken by corporate business and financed out of the liquid reserves the latter had been holding with the banking system.

(¹) The term "inflationary" as used in this connection has therefore no derogatory connotation. It simply means: "increasing the volume of total expenditure".

Question 3:

What, in your view, are the limitations of monetary policy?

Limitations of monetary policy

(29) When speaking about the limitations of monetary policy one should distinguish, in my opinion, between the limitations that rightly must be set to the range of objectives of monetary policy, and the limitations monetary policy has to face in trying to achieve these objectives.

(30) The answer to the first question has already been given in my reply to question (1), from which it appears that I believe that monetary policy must not be asked to aim for more than for establishing and maintaining conditions of internal and external monetary equilibrium, i.e. the conditions that in the long run are most conducive to the realization of full employment and of sustainable growth.

It should not be used, and for practical purposes can hardly be used without ultimately betraying its true objectives, as an instrument to achieve a fairer distribution of income, a more preferable distribution of expenditure or a more rapid rate of growth.

(31) As to the limitations monetary policy encounters in the pursuit of its proper objectives, I think it is useful to distinguish between three types, viz.

(a) limitations of an institutional character,

(b) limitations of an operational character,

(c) limitations due to contradictions of purpose.

(32) Limitations of an institutional character can be due to the institutional traditions of a country or to rules and regulations set by law or statute, limiting the field of action or the instruments of policy of monetary authorities.

It would certainly go beyond the scope of this memorandum to try to give an exhaustive survey of all possible limitations of this type. They become apparent whencomparing the differences of law and tradition between one country and the other. As an example of different institutional traditions one might mention:

(a) whether the market has an automatic access to central bank credit, as in the United Kingdom, or only by way of privilege, as in the United States; (b) whether the banking system follows hard and fast rules of liquidity - and cash - ratios as in the United Kingdon, or does not; (c) whether a country knows clear functional separations between money market and capital markets and between deposit banks and saving banks or does not. As examples of legal differences one might think of: (d) whether the central bank has or has not the power to finance Government directly; (e) whether the central bank can or cannot give

(a) limitations of an institutional character,

(b) limitations of an operational character;

(c) limitations due to contradictions of purpose.

(32) Limitations of an institutional character can be due to the institutional traditions of a country or to rules and regulations set by law or statute, limiting the field of action or the instruments of policy of monetary authorities.

It would certainly go beyond the scope of this memorandum to try to give an exhaustive survey of all possible limitations of this type. They become apparent whencomparing the differences of law and tradition between one country and the other. As an example of different institutional traditions one might mention:

(a) whether the market has an automatic access to central bank credit, as in the United Kingdom, or only by way of privilege, as in the United States; (b) whether the banking system follows hard and fast rules of liquidity - and cash - ratios as in the United Kingdom, or does not; (c) whether a country knows clear functional separations between money market and capital markets and between deposit banks and saving banks or does not. As examples of legal differences one might think of: (d) whether the central bank has or has not the power to finance Government directly; (e) whether the central bank can or cannot give

directions to the banking system for the conduct of their (reserve requirements, credit ceilings, etc.); and (f) whether the Government is or is not subject to limitations as to interest policy and volume of debt.

(33) Limitations resulting from law and tradition will not make monetary policy impotent. They may, however, be rather frustrating and they certainly mean that in different countries different techniques have to be followed to accomplish comparable aims.

The limitations set by tradition are usually difficult to overcome. Yet, they may be utterly important, as they may for example, be decisive for the possibility of choice between being restrictive by limitation of accommodation, or only by increasing discount rates.

Limitations of law have a slightly better chance of disappearance. Laws, after all, are sometimes changed, and these changes can be helpful, by the introduction of new techniques, in creating possibilities to bypass the limitations set by tradition.

For the benefit of the efficacy of national monetary policies and for the benefit of constructive international monetary cooperation, it must be hoped that future legislation will give monetary authorities the widest possible choice of instruments to be used in the pursuit of their task.

(34) It is particularly central bank policy that is subject to limitations of an operational character.

directions to the banking system for the conduct of their (reserve requirements, credit ceilings, etc.); and (f) whether the Government is or is not subject to limitation as to interest policy and volume of debt.

(33) Limitations resulting from law and tradition will not make monetary policy impotent. They may, however, be rather frustrating and they certainly mean that in different countries different techniques have to be followed to accomplish comparable aims.

The limitations set by tradition are usually difficult to overcome. Yet, they may be utterly important, as they may for example, be decisive for the possibility of choice between being restrictive by limitation of accommodation, or only by increasing discount rates.

Limitations of law have a slightly better chance of disappearance. Laws, after all, are sometimes changed, and these changes can be helpful, by the introduction of new techniques, in creating possibilities to bypass the limitations set by tradition.

For the benefit of the efficacy of national monetary policies and for the benefit of constructive international monetary cooperation, it must be hoped that future legislation will give monetary authorities the widest possible choice of instruments to be used in the pursuit of their task.

(34) It is particularly central bank policy that is subject to limitations of an operational characte

Central banks and the banking system are, after all, not in the business of spending and investing themselves, but only in the business of making, indirectly or directly, credit available to the business community and to the Government. The intiative for expenditure has to be taken by the borrower and the central bank can hardly do more than making credit tighter when demand is large and total expenditure is on the increase, or making credit easier when demand slackens and total expenditure tends to fall. Central bank policy can therefore only to a limited extent be of a truly compensatory nature. It can, in a boom, choke off the increase of expenditure; it can, by doing so, even force expenditure down below the inflationary level to which it had, by the use of bank credit and activation of idle liquidity, risen in the period before. But it cannot, for all practical purposes, bring total expenditure down by actually reducing the volume of bank credit during a boom, or bring it up by actually increasing the volume of credit during a recession.

It is true that, in theory, it would be conceivable that a central bank might dispose of an open market portfolio of such magnitude and such composition that it could sell during the upward phase of the cycle, sufficient paper to draw an appreciable part of current savings out of the market, thus depriving the private sector of means of finance and forcing it to a cut of expenditure. Practically, however, such a policy can only be followed by Government. Likewise, only Government

Central banks and the banking system are, after all, not in the business of spending and investing themselves, but only in the business of making, indirectly or directly, credit available to the business community and to the Government. The intiative for expenditure has to be taken by the borrower and the central bank can hardly [illegible] more than making credit tighter when demand is large and total expenditure is on the increase, or making credit easier with lower interest when total expenditure tends to fall. Central bank policy can therefore only to a limited extent be of a truly compensatory nature. It can, in a boom, choke off the increase of expenditure; it can, by doing so, even force expenditure down below the inflationary level to which it had, by the use of easy credit and activation of idle liquidity, [illegible] in the period before. But it cannot, for all practical purposes, bring total expenditure down by actually lessening the volume of bank credit during a boom, or bring it up by actually increasing the volume of credit during a recession.

It is true that, in theory, it would be conceivable that a central bank might dispose of an open market portfolio of such magnitude and such composition that it could sell during the upward phase of the cycle, sufficient paper to draw an appreciable part of current savings out of the market, thus depriving the private sector of means of finance and forcing it to a cut of expenditure. Practically, however, such a policy can only be followed by Government. Likewise, only Government

has the power to cut or to increase its own expenditure in order to compensate for fluctuations in expenditure by the private sector, or to increase or decrease taxation with the same purpose.

In this sense it is only Government policy that can be fully compensatory. Central bank policy must limit itself to creating the conditions in which over-expenditure will automatically come to a stop because it has exhausted the possibilities of inflationary financing on which it feeds itself. It must also, in periods of underexpenditure limit itself to creating the conditions most conducive to recovering. I believe that central bank policy has the greatest possibilities of success in the first-named period, and Government monetary policy in the second one. The best results, however, will ensue when the two cooperate.

(35) The limitation of monetary policy that can haunt authorities most is no doubt the one which results from the impossibility, under certain circumstances, of taking measures that will simultaneously tend to fulfill the three equilibrium conditions implied by the definition of the objective of monetary policy, as given in paragraph (1), viz. price stability, balance of payments equilibrium and full employment.

For the authorities such impossibility may create a most vexing contradiction of purpose: they must ultimately decide to give precedence to either one or the other part of their joint objective. The causes of such a situation may find their origin abroad or at home.

(36) The classical case in which the causes of disturbance come from abroad is that of a country that by itself enjoys conditions of perfect internal equilibrium, but that is being faced by a balance of payments surplus (or deficit) resulting from an increased (or decreased) export demand which is clearly caused by inflationary (or deflationary) conditions abroad. Usually such country will just have to ride out the storm and to absorb the disagreeable consequences, in the expectation that the countries where the monetary disturbance originated will take the proper measure of rectification. But if the disturbing condition continues too long, the moment may come when authorities have to choose between trying to maintain the internal value of their currency by changing the exchange parity, or maintaining the exchange rates but giving up to strive for internal price stability.

Some of the devaluations of the thirties and of the re-valuations of the period just after the war may well be attributed to this dilemma.

(37) A more subtle case of monetary disturbance coming from abroad is the one in which the country which originally found itself in an equilibrium condition is faced with a balance of payments surplus due to (a) increased exports caused not by inflationary conditions abroad, but rather by shifts of demand in international trade or by (b) an inflow of foreign capital.

The difference with the situation discussed in the previous paragraph is that from a world point-of-view

(36) The classical case in which the causes of disturbance come from abroad is that of a country that by itself enjoys conditions of perfect internal equilibrium, but that is being faced by a balance of payments surplus (or deficit) resulting from an increased (or decreased) export demand which is clearly caused by inflationary (or deflationary) conditions abroad. Usually such country will just have to ride out the storm and to absorb the disagreeable consequences, in the expectation that the countries where the monetary disturbance originated will take the proper measure of rectification. But if the disturbing condition continues too long, the moment may come when authorities have to choose between trying to maintain the internal value of their currency by changing the exchange parity, or maintaining the exchange rates but giving up to strive for internal price stability.

Some of the devaluations of the thirties and of the re-valuations of the period just after the war may well be attributed to this dilemma.

(37) A more subtle case of monetary disturbance coming from abroad is the one in which the country which originally found itself in an equilibrium condition is faced with a balance of payments surplus due to (a) increased exports caused not by inflationary conditions abroad, but rather by shifts of demand in international trade or by (b) an inflow of foreign capital.

The difference with the situation discussed in the previous paragraph is that from a world point-of-view

there is no question of a monetary disturbance at all. This is not the case of an increase in total expenditure made possible by inflationary financing, but of a shift in expenditure for goods and services in the private or in the Government sector from spending in one country to spending in another one. The fact of the matter is, however, that these shifts present themselves from the national point of view as monetary disturbances because surpluses and deficits in the balance of payments automatically mean that much creation or cancellation of money. In the case just mentioned it will be observed that in some other country or countries the reverse phenomenon occurs, viz. a balance of payments deficit due to increased imports of goods and services or to an inflow of capital. One will also find that this balance of payments deficit - otherwise than one caused by monetary inflation at home - is accompanied by a falling-off of total expenditure in the home market and, as a consequence, by generally recessive conditions.

It will easily be seen that the described situation is in many respects characteristic of the relationship that has, for the last few years, existed between continental Europe and the United States.

(38) In the situation to which the previous paragraph refers monetary authorities in the surplus country will be inclined, in defense of their internal equilibrium and of the purchasing power of their monetary unit, to take restrictive measures. In the deficit country on the other hand, especially so long

there is no question of a general disturbance at all. This is not the case of an increase in total expenditure made possible by inflationary financing, but of a shift in expenditure for goods and services in the private or in the Government sector from spending in one country to spending in another one. The fact of the matter is, however, that these shifts present themselves from the national point of view as monetary disturbances because surpluses and deficits in the balance of payments automatically mean that much creation or cancellation of money. In the case just mentioned it will be observed that in some other country or countries the reverse phenomenon occurs, viz. a balance of payments deficit due to increased imports of goods and services or to an inflow of capital. One will also find that this balance of payments deficit - otherwise than one caused by monetary inflation at home - is accompanied by a falling-off of total expenditure in the home market and, as a consequence, is generally [illegible] conditions.

It will easily be seen that the described situation is in many respects characteristic of the relationship that has, for the last few years, existed between continental Europe and the United States.

(38) In the situation to which the previous paragraph refers monetary authorities in the surplus country will be inclined, in defense of their internal equilibrium and of the purchasing power of their monetary unit, to take restrictive measures. In the deficit country on the other hand, especially so long

as the reserve situation does not look too disturbing, they will be disposed to follow an expansionary monetary policy, in order to correct the drop in home demand and to counteract the tendency to underemployment. Thus, on both sides, policies may be followed that can only serve to prolong and perhaps even to reinforce the balance of payments problems that both parties have to face.

(39) The answer to the authorities' dilemma is that the situation does not ask for this type of monetary action at all. One cannot correct by deflationary or inflationary measure a disturbance that fundamentally has no monetary causes, and, as we have already seen, the present one has not. If the shift of demand - or the movement of capital - that caused the balance of payments problem is of a temporary nature only, monetary reserves will have to absorb the ultimate net effect. If the shift is of a permanent character an adaptation in the cost relationships between the surplus and the deficit countries will have to create a new situation of trade equilibrium.

This adaptation may come from the slow process of increases in unit cost in the surplus country - which unavoidably will bring some drop in the purchasing power of money - and from some decrease in unit cost in the deficit country. It may also come from a change of parity on either side. This means that the final solution will force monetary authorities to either sacrifice the internal, or the external value of their monetary unit.

as the reserve situation does not look too disturbing. [illegible] policy, in order to correct the drop in home demand and to counteract the tendency to underemployment. Thus, on both sides, policies may be followed that can only serve to prolong and perhaps even to reinforce the balance of payments problems that both parties have to face.

(39) The answer to the authorities' dilemma is that the situation does not ask for this type of monetary action at all. One cannot correct by deflationary or inflationary measure a disturbance that fundamentally has no monetary causes, and, as we have already seen, the present one has not. If the shift of demand – or the movement of capital – that caused the balance of payments problem is of a temporary nature only, monetary reserves will have to absorb the ultimate net effect. If the shift is of a permanent character an adaptation in the cost relationships between the surplus and the deficit countries will have to create a new situation of trade equilibrium.

This adaptation may come from the slow process of increases in unit cost in the surplus country – which unavoidably will bring some drop in the purchasing power of money – and from some decrease in unit cost in the deficit country. It may also come from a change of parity on either side. This means that the [illegible]

(40) The shift of demand in international trade discussed in the previous paragraph need not be a spontaneous one. It may be the reaction to preceding differential cost developments between countries and more specifically to increases in labour cost that outstrip increases in productivity, either in a country generally, or in the important export industries of a country. It is also conceivable that such increases in labour cost lead not only to shifts in international demand, but also to shifts in national demand, thus creating partial unemployment.

It will be well to remember that also this phenomenon of "cost-inflation" or "wage-inflation", as it is often referred to, is beyond the reach of monetary policy to rectify. The price increases it may bring cannot be corrected by a restrictive policy without creating more unemployment. Nor can the unemployment be corrected by an expansionary policy without creating more balance of payment troubles.

Monetary policy is not and cannot be a cure-all. Its true limitations are that it is an instrument of policy which should be used neither for more, nor for less, than for preventing, as far as possible, and for correcting if need be, disturbances of a monetary nature only.

Question 4:

What are the responsibilities of your bank in setting the objectives of, and executing, your government's debt management policy? To what extent do you believe debt management policy and monetary policy must be closely, if not entirely, linked together?

Debt management

(41) The technical scope of debt management in the Netherlands is more restricted than in the Anglo-Saxon countries. The main reasons are that

(a) Government follows the rule not to finance budgetary expenditure with money market resources. Consequently net money market operations are, generally, restricted to taking care of seasonal fluctuations in Government income and expenditure; and that

(b) Government borrowing on the capital market, generally, takes the form of issuing 25 to 40 year loans, repayment of which takes place by redemption spread over the life time of the loan. Consequently there are very few loans with fixed maturity and long term loans therefore do not gradually become money market material.

(42) As a consequence of the condition mentioned above sub (b) there exists a clear separation between what is considered the Government's short term debt (treasury bills and treasury notes) and its long term debt (mainly bonds) and also between the money market and the capital market. The commercial banks do not operate, generally, in the bond market. The only form of long term Government paper they hold to any important extent consists of 1,200 million guilders of 8, 10 and 12 year treasury certificates created in 1954 by way of

Question 4:

What are the responsibilities of your bank in setting the objectives of, and executing, your government's debt management policy? To what extent do you believe debt management policy and monetary policy must be closely, if not entirely, linked together?

Debt management

(41) The technical scope of debt management in the Netherlands is more restricted than in the Anglo-Saxon countries. The main reasons are that

(a) Government follows the rule not to [illegible]

Consequently net money market operations are, generally, restricted to taking care of seasonal fluctuations in Government income and expenditure; and that

(b) Government borrowing on the capital market, generally, takes the form of issuing 25 to 40 year loans, repayment of which takes place by redemption spread over the life time of the loan. Consequently there are very few loans with fixed maturity and long term loans therefore do not gradually become money market paper.

(42) As a consequence of the condition mentioned above sub (b) there exists a clear separation between what is considered the Government's short term debt (treasury bills and treasury notes) and its long term debt (mainly bonds) and also between the money market and the capital market. The commercial banks do not operate, generally, in the bond market. The only form of long term Government paper they hold to any important extent consists of 1,200 million guilders of 8, 10 and 12 year treasury certificates created in 1954 by way of

consolidation of short term debt in the hands of the banking system, and only negotiable between the banks themselves. (The 1962 maturity of these certificates was prolonged for another 10 years.)

(43) Operations of a debt management character that might occur under conditions presently prevailing in the Netherlands are:

(a) increasing long term debt in order to finance budgetary expenditure;

(b) increasing long term debt in order to repay short term debt, or, at any rate, to sterilize the proceeds;

(c) increasing long term internal debt in order to repay foreign debt;

(d) repayment of long term debt out of current income;

(e) repayment of long term debt out of increases in short term debt;

(f) increase of short term internal debt to repay foreign debt;

(g) repayment of short term debt out of current income;

(h) manipulation of the average maturity of the short term debt.

(44) From the point of view of monetary policy I consider the transactions mentioned above sub (a), (d) and (f) as neutral, as they generally will not affect the internal expenditure/output relationship. It is assumed that capital market resources will ultimately

consolidation of short term debt in the hands of the banking system, and only negotiable between the banks themselves. (The 1962 maturity of these certificates was prolonged for another 10 years.)

(43) Operations of a debt management character that might occur under conditions presently prevailing in the Netherlands are:

(a) increasing long term debt in order to finance budgetary expenditure;

(b) increasing long term debt in order to repay short term debt, or, at any rate, to sterilize its proceeds;

(c) increasing long term internal debt in order to repay foreign debt;

(d) repayment of long term debt out of current income;

(e) repayment of long term debt out of increases in short term debt;

(f) increase of short term internal debt to repay foreign debt;

(g) repayment of short term debt out of current income;

(h) manipulation of the average maturity of the short term debt.

(44) From the point of view of monetary policy I consider the transactions mentioned above sub (a), (c) and (f) as neutral, as they generally will not affect the internal expenditure/output relationship. It is assumed [illegible] will ultimately

find their way into investment. The Government's activity on the market may somewhat speed-up or slow-down this process, but will in the end only affect the rate of interest and not the volume of expenditure. There may, however, be an indirect influence, through the rate of interest, on the balance of international capital movements. The transaction sub (f) will likewise tend to leave the internal demand/supply relationship undisturbed, but will, of course, affect the foreign exchange reserves held by the authorities or by the banking system.

(45) The transactions mentioned in paragraph 43, sub (b), (c) and (g) are clearly of a deflationary, or rather of a counter-inflationary, character, as they tend to reduce actual or potential expenditure by taking money out of the flow of savings ((b) and (c)), respectively straight out of the flow of income ((g)), or out of an existing stock of excess liquidity, without these proceeds being fed back into the flow of expenditure.

The Netherlands Government has repeatedly made use of these techniques to compensate inflationary pressures, as for example in the late forties to consolidate still existing excess liquidity, and in the periods of 1953/55 and 1960/62 to compensate the influence of inflow of foreign capital and excessive export demand.

(46) This leaves us to account for the transactions mentioned in paragraph 43, sub (e) and (h).

The first one is clearly of an inflationary, or reflationary, character. It has so far never been made use of in the Netherlands. Conceivably it might be part of a reflationary programme in a period of serious recession.

Transaction (h), the manipulation of the average maturity of the short term debt, must be considered as having a potential indirectly bearing on the expenditure/output relationship, inasmuch as it will affect the liquidity situation of the banking system, and, to some extent also of the private sector of the economy generally. In the Netherlands it takes the form of influencing the average maturity of the outstanding volume of treasury bills, which usually run from three months to one year, and treasury notes usually running from 2 years to 5 years. This short term Government paper constitutes the main investment opportunity on the money market. A large part of it is being held by the banking system.

(47) The responsibility for debt management as far as the operations of the Government are concerned, lies with the Government, who acts not through the Bank, but through its own agency in Amsterdam.

The Bank, however, has a responsibility of its own for buying or selling Government paper for, respectively out of, its own portfolio. The Bank will transact these operations for reasons of monetary policy only. It has the authority to operate in the long term market as well as in the short term market,

The first one is clearly of an inflationary, or reflationary, character. It has so far never been made use of in the Netherlands. Conceivably it might be part of a reflationary programme in a period of serious recession.

Transaction (n), the manipulation of the average maturity of the short term debt, must be considered as having a potential indirectly bearing on the expenditure/output relationship, inasmuch as it will affect the liquidity situation of the banking system, and, to some extent also of the private sector of the economy generally. In the Netherlands it takes the form of influencing the average maturity of the outstanding volume of treasury bills, which usually run from three months to one year, and treasury notes usually running from 2 years to 5 years. This short term Government paper constitutes the main investment opportunity on the money market. A large part of it is being held by the banking system.

(47) The responsibility for debt management as far as the operations of the Government are concerned, lies with the Government, who acts not through the Bank, but through its own agency in Amsterdam.

The Bank, however, has a responsibility of its own for buying or selling Government paper for, respectively out of, its own portfolio. The Bank will transact these operations for reasons of monetary policy only. It has the authority to operate in the long term market as well as in the short term market

but has, so far, only operated in the money market.

The Bank advises the Government with respect to the Government's operations. It will not operate itself without previous consultation with the Government.

(48) Debt management, when defined in the broad sense used in the foregoing paragraphs, and therefore including not only the management of existing debt, but also the increasing or reducing of debt, embraces all the activities of Government of a monetary nature, viz the creation and cancellation of money and near-money and the exerting of an influence on the rate of interest. It therefore includes the very essence of what I have called previously monetary policy of the Government.

It must be clear, therefore, that I indeed believe debt management, for that part of it, to be entirely linked together with monetary policy in general.

but has, so far, only operated in the money market.

The Bank advises the Government with respect to the Government's operations. It will not operate itself without previous consultation with the Government.

(48) Debt management, when defined in the broad sense used in the foregoing paragraphs, and therefore including not only the management of existing debt, but also the increasing or reducing of debt, embraces all the activities of Government of a monetary nature, viz the creation and cancellation of money and near-money and the exerting of an influence on the rate of interest. It therefore includes the very essence of what I have called previously monetary policy of the Government.

It must be clear, therefore, that I indeed believe debt management, for that part of it, to be entirely linked [illegible] with monetary policy in general

Question 5a:

Could you elaborate for this Commission your analysis of the ways in which the various techniques of monetary control are made effective?

Techniques of monetary policy

(49) The instruments of policy the Netherlands Bank has at its disposal to make its monetary control effective are:

(a) discount policy;

(b) open market policy;

(c) variation of cash reserve requirements;

(d) the giving of directions to the banking system.

(50) The use of discount policy has two aspects, viz. (a) the fixing of the rate of interest at which the Bank's credit shall be available, and (b) the willingness of the Bank to admit borrowers to its facilities.

Though by tradition the rate of interest charged by the banking system for its loans is for a large part linked to the official discount rate, the significance of the latter rate in determining the volume of credit available to the economy should not be overestimated. Experience does not show the demand for credit to be very sensitive to the price and the variations in the discount rate are not necessarily linked with changes in the availability of credit to the public. The banking system is not usually indebted to the central bank, and when it is not, the bank may have to use other means than the control of the price and the availability of its own credit to exert an

Question 4a)

Could you elaborate for this Commission your analysis of the ways in which the various techniques of monetary control are made effective?

Techniques of monetary policy

(49) The instruments of policy the Netherlands Bank has at its disposal to make its monetary control effective are:

(a) discount policy;

(b) open market policy;

(c) variation of cash reserve requirements;

(d) the giving of directions to the banking system.

(50) The use of discount policy has two aspects, viz. (a) the fixing of the rate of interest at which the Bank's credit shall be available, and (b) the willingness of the Bank to admit borrowers to its facilities.

Though by tradition the rate of interest charged by the banking system for its loans is for a large part linked to the official discount rate, the significance of the latter rate in determining the volume of credit available to the economy should not be overestimated. Experience does not show the demand for credit to be very sensitive to the price and the variations in the discount rate are not necessarily linked with changes in the availability of credit to the public. The banking system is not usually indebted to the central bank, and when it is not, the bank may have to use other means than the control of the price and the availability of its own credit to exert an

influence on the volume of credit.

(51) Nevertheless there are occasionally periods during which the market has to take recourse to the Bank. For such periods it is important that the Bank takes the view that making use of its facilities is not a right, but only a privilege that can be made use of only temporarily. Thus, once the market has recourse to the Bank, the latter can exert a direct control on the volume of its credit.

This also gives the opportunity of making special conditions. In 1957, for example, the Bank announced penal discount rates for banks that might have exceeded certain limits of credit expansion. Likewise in 1957 it made facilities to the savings banks dependent upon their not making any further investments, as long as they were indebted to the Bank. Finally, the discountability of short term paper of local public authorities is made dependent upon the volume of their short term debt.

(52) The automatic availability of the Bank's credit to the Treasury is limited to an interest-free debit margin of 150 million guilders. The Bank is free to buy treasury paper from the market or from the Treasury directly. There exists an understanding between the Treasury and the Bank that the latter cannot be expected to accommodate the Treasury for the purpose of financing budgetary expenditure. On the other hand the Bank has been willing in many instances to finance the Government for other purposes, such as repayment of debt to the money market. Likewise the Bank has been willing

influence on the volume of credit.

(51) Nevertheless there are occasionally periods during which the market has to take recourse to the Bank. For such periods it is important that the Bank takes the view that making use of its facilities is not a right, but only a privilege that can be made use of only temporarily. Thus, once the market has recourse to the Bank, the latter can exert a direct control on the volume of its credit.

This also gives the opportunity of making special conditions. In 1957, for example, the Bank announced penal discount rates for banks that might have exceeded certain limits of credit expansion. Like-wise in 1957 it made facilities to the savings banks dependent upon their not making any further investments, as long as they were indebted to the Bank. Finally, the discountability of short term paper of local public authorities is made dependent upon the volume of their short term debt.

(52) The automatic availability of the Bank's credit to the Treasury is limited to an interest-free debit margin of 150 million guilders. The Bank is free to buy treasury paper from the market or from the Treasury directly. There exists an understanding between the Treasury and the Bank that the latter cannot be expected to accommodate the Treasury for the purpose of financing budgetary expenditure. On the other hand the Bank has been willing in many instances to finance the Government for other purposes, such as repayment of debt

to finance the Treasury for drawings of guilders by the International Monetary Fund and occasionally for repayment of other foreign debt.

(53) In principle the Bank is in a position to exert an influence on the liquidity of the banking system by its open-market-policy. In practice there is not much room for this policy, as the open market portfolio of the Bank is small - presently about 250 million guilders - and consists mainly of paper with a maturity of less than one year. For this reason the open market portfolio has mainly been used in the last few years to maintain orderly conditions on the money market and to buffer fluctuations in the cash liquidity of the banks.

The fundamental cause of the limited volume of the open market portfolio is to be found in the fact that the gold and foreign exchange reserves the Bank holds, though not representing more than about four months' imports, are about equal to the banknote circulation increased by the average credit balance of the Government. This situation leaves only limited room for holding other assets.

(54) It was this same circumstance that has led in 1954 to the introduction, by gentleman's agreement between the Bank, the commercial banks, the agricultural credit banks and the postal giro-system, of the system of obligatory cash reserves. According to this agreement the Bank, taking into consideration the fluctuations in the foreign exchange reserves and the causes thereof, will

to finance the Treasury for drawings of guilders by the International Monetary Fund and occasionally for repayment of other foreign debt.

(53) In principle the Bank is in a position to exert an influence on the liquidity of the banking system by its open-market-policy. In practice there is not much room for this policy, as the open market portfolio of the Bank is small - presently about 250 million guilders - and consists mainly of paper with a maturity of less than one year. For this reason the open market portfolio has mainly been used in the last few years to maintain orderly conditions on the money market and to buffer fluctuations in the cash liquidity of the banks.

The fundamental cause of the limited volume of the open market portfolio is to be found in the fact that the gold and foreign exchange reserves the Bank holds, though not representing more than about four months' imports, are about equal to the banknote circulation increased by the average credit balance of the Government. This situation leaves only limited room for holding other assets.

(54) It was this same circumstance that has led in 1954 to the introduction, by gentleman's agreement between the Bank, the commercial banks, the agricultural credit banks and the postal giro-system, of the system of obligatory cash reserves. According to this agreement the Bank, taking into consideration the fluctuations in the foreign exchange reserves and the causes thereof, wil

determine monthly the percentage of cash reserves in proportion to deposits the banks shall hold on a non-interest bearing account with the Bank. The percentage shall not exceed 15. It presently amounts to 8. An increase in foreign exchange reserves, which would be accompanied by an increased liquidity of the banks, would lead the Bank to increase the reserve ratio. A drop in exchange reserves, provided it would not be caused by excessive credit expansion by the banks, would lead to a reduction of the reserve ratio.

For all practical purposes the obligatory cash reserves act as an extension of the Bank's open market policy. Reserve ratios have occasionally been changed for purely internal reasons with no relation to fluctuations in the exchange reserves.

(55) The Act on Supervision of the Credit System of 1956 authorizes the Bank to give credit institutions <u>general directions</u> for the conduct of their business if it deems this necessary in carrying out the task laid upon it in Art. 9 of the Bank Act of 1958, i.e. its task of regulating the value of the monetary unit. Such directions may contain provisions regarding: (a) minimum liquidity ratios, (b) maximum extent of loans or investments, and (c) prohibition or limitation of specified types or forms of credit. Such directions can be given either in agreement with the representative organizations of the group of credit institutions concerned, or without such agreement. In the first case they are immediately effective; in the latter case they

determine monthly the percentage of cash reserves in proportion to deposits the banks shall hold on a non-interest [illegible] account with the Bank. The [illegible] shall not exceed 15. It presently amounts to 8. An increase in foreign exchange reserves, which would be accompanied by an increased liquidity of the banks, would lead the Bank to increase the reserve ratio. A drop in exchange reserves, provided it would not be caused by excessive credit expansion by the banks, would lead to a reduction of the reserve ratio.

For all practical purposes the [illegible] cash reserves act as an extension of the Bank's open market policy. Reserve ratios have occasionally been changed for purely internal reasons with no relation to fluctuations in the exchange reserves.

(55) The Act on Supervision of the Credit System of 1956 authorizes the Bank to give credit institutions <u>general directions</u> for the conduct of their business if it deems this necessary in carrying out the task laid [illegible] of regulating the value of the monetary unit. Such [illegible] liquidity ratios, (b) maximum extent of loans or investments, and (c) prohibition or limitation of specified types or forms of credit. Such directions can be given either in agreement with the representative organizations of the group of credit institutions concerned, or without such agreement. In the first case they are immediately effective; in the latter case they

first need the approval of the Minister of Finance. Moreover, within three months, a bill will then have to be introduced in parliament, confirming them.

When, in 1959, as a consequence of large balance of payment surpluses the liquidity of the banking system became such that it would no longer be possible for the Bank to effectively curb, in case of need, a credit expansion by means of its open market and cash reserve policies, the Bank started consultations with the representative organizations of the commercial banks and of the agricultural credit banks. These consultations led, in 1960, to an agreement, giving the Bank the power to direct the banks to limit credit expansion in relation to an agreed basic period, under penalty for the individual banks of having to deposit with the Bank an amount maximally equal to any individual transgression of the admissible ceiling provided that also the collectivity of the banks would be in infringement. In the summer of 1961 limits to credit expansion were actually introduced. Since January 1962 the established ceilings are being transgressed and 100 per cent deposits are being made.

It is believed that the described technique will enable the Bank to curb credit expansion even though the liquidity of the banks and the volume of their foreign assets would make them insusceptible to normal central bank pressure. It is too early, perhaps, to finally judge the merits of the technique, but there seems to be no doubt that during the past year it has appreciably affected the banking system's credit policies.

first need the approval of the Minister of Finance. Moreover, within three months, a bill will then have to be introduced in parliament, confirming them.

When, in 1959, as a consequence of large balance of payment surpluses the liquidity of the banking system became such that it would no longer be possible for the Bank to effectively curb, in case of need, a credit expansion by means of its open market and cash reserve policies, the Bank started consultations with the representative organizations of the commercial banks and of the agricultural credit banks. These consultations led, in 1960, to an agreement, giving the Bank the power to direct the banks to limit credit expansion in relation to an agreed basic period, under penalty for the individual banks of having to deposit with the Bank an amount maximally equal to any individual transgression of the admissible ceiling provided that also the collectivity of the banks would be in infringement. In the summer of 1961 limits to credit expansion were actually introduced. Since January 1962 the established ceilings are being transgressed and 100 per cent deposits are being made.

It is believed that the described technique will enable the Bank to curb credit expansion even though the liquidity of the banks and the volume of their foreign assets would make them insusceptible to normal central bank pressure. It is too early, perhaps, to finally judge the merits of the technique, but there seems to be no doubt that during the past year it has appreciably affected the banking system's credit policies.

(56) The Bank so far has not made use of its power to give the banking system directions regarding liquidity ratios or regarding limitation or prohibition of specified types or forms of credit. It has, however, made use of <u>moral suasion</u> in this direction, as when, in 1957, it asked the banks to limit their loans to the municipalities which at that time were financing investment by short term borrowing, and when, in 1955, it requested the banks to reduce their lending for investment purposes and hire-purchase financing.

(57) The paragraphs 49 to 56 having exhausted the subject of the techniques of central bank monetary policy, your question might now lead to a discussion of the techniques of Government monetary policy. It would seem to me, however, that further elaboration on this subject, after what has been said on the subject of debt management in the paragraphs 43 and following, is no longer necessary.

(56) The Bank so far has not made use of its power to give the banking system directions regarding liquidity ratios or regarding limitation or prohibition of specified types or forms of credit. It has, however, made use of moral suasion in this direction, as when, in 1957, it asked the banks to limit their loans to the municipalities which at that time were financing investment by short term borrowing, and when, in 1955, it requested the banks to reduce their lending for investment purposes and hire-purchase financing.

(57) The paragraphs 49 to 56 having exhausted the subject of the techniques of central bank monetary policy, your question might now lead to a discussion of the techniques of Government monetary policy. It would seem to me, however, that further elaboration on this subject, after what has been said on the subject of debt management in the paragraphs 43 and following, is no longer necessary.

Question 5b:

To what extent do you believe that the monetary authorities must have control over the so-called "near banks" in countries where these institutions are becoming highly developed?

The monetary significance of near banks

(58) In the Netherlands the Act on Supervision of the Credit System of 1956 brings all credit institutions under supervision of the Netherlands Bank. By credit institutions the Act means: commercial banks, agricultural credit banks, security credit institutions and general savings banks. By commercial banks it means all corporate bodies, partnerships and physical persons that to a substantial extent make it their business to accept monies on deposit for their own account, and to grant credits for their own account, with the exception of the agricultural credit banks and the security credit institutions, which are separately defined. By general savings banks the Act means all corporate bodies which devote themselves exclusively to the promotion of saving and with that object accept monies on deposit.

The system of the Act means that, practically, all deposit receiving institutions come under the control of the Bank and that no such institution could escape control if it also grants credits to a substantial extent. Finance-companies and building societies do not finance themselves in the Netherlands with deposits but only with fixed loans.

(59) The Bank, according to the Act, can give and actually has given, to all the institutions under its supervision directives for the conduct of their business

Question 5b:

To what extent do you believe that the monetary authorities must have control over the so-called "near banks" in countries where these institutions are becoming highly developed?

The monetary significance of near banks

(58) In the Netherlands the Act on Supervision of the Credit System of 1956 brings all credit institutions under supervision of the Netherlands Bank. By credit institutions the Act means: commercial banks, agricultural credit banks, security credit institutions and general savings banks. By commercial banks it means all corporate bodies, partnerships and physical persons that to a substantial extent make it their business to accept monies on deposit for their own account, and to grant credits for their own account, with the exception of the agricultural credit banks and the security credit institutions, which are separately defined. By general savings banks the Act means all corporate bodies which devote themselves exclusively to the promotion of saving and with that object accept monies on deposit.

The system of the Act means that, practically, all deposit receiving institutions come under the control of the Bank and that no such institution could escape control if it also grants credits to a substantial extent. Finance-companies and building societies do not finance themselves in the Netherlands with deposits but only with fixed loans.

(59) The Bank, according to the Act, can give and actually [illegible] give, to all the institutions under its supervision directives for the conduct of their business

in the interest of the solvency and liquidity of the said institutions. It also can give them, as I have already mentioned in paragraph 55, directions for reasons of monetary policy.

The fact of the matter is, however, that so far the Bank has given such monetary directions only to the banking system. It has not found it necessary to extend them to the savings banks, because it has not believed the savings banks to exert any appreciable monetary influence. The monies deposited with these banks can generally be considered to actually represent spontaneous private savings; they are only to a small extent just temporarily idle cash balances.

Nevertheless the Bank has observed instances where savings - banks have been extending facilities to their depositors which tended to give the savings deposits the character of cash balances. Such facilities have been accompanied with an appreciable increase in the velocity of turnover of such deposits. The Bank is closely studying this situation. It might consider for reasons of monetary policy to subject institutions where such facilities are given to more severe prescriptions than other savings banks.

(60) It would seem somewhat rash to jump, on the basis of Netherlands experience only, to policy conclusions about a country with a very different situation. Yet, I believe that the following considerations are pertinent to the question whether "near banks" should or should not be brought under control of

[illegible]

said institutions. It also can give them, as I have already mentioned in paragraph 55, directions for reasons [illegible]

The fact of the matter is, however, that so far the Bank has given such monetary directions only to the banking system. It has not found it necessary to extend them to the savings banks, because it has not believed the savings banks to exert any appreciable monetary influence. The monies deposited with these banks can generally be considered to actually represent spontaneous private savings; they are only to a small extent just temporarily idle cash balances.

Nevertheless the Bank has observed instances where savings - banks have been extending facilities to their depositors which tended to give the savings deposits the character of cash balances. Such facilitie have been accompanied with an appreciable increase in the velocity of turnover of such deposits. The Bank is closely studying this situation. It might consider for reasons of monetary policy to subject institutions where such facilities are given to more severe prescriptions than other savings banks.

(60) It would seem somewhat rash to jump, on the basis of Netherlands experience only, to policy conclusions about a country with a very different situation. Yet, I believe that the following considerations are pertinent to the question whether "near banks" should or should not be brought under control of

monetary authorities:

(a) As long as the monies deposited with so-called "near banks" can be supposed to essentially represent spontaneous private savings only, their monetary influence can be discounted. It is true that even then they may have some stimulating influence on the velocity of circulation of money - namely in so far as deposits do not originate from current savings but from hoards of money representing old savings - but this factor may safely be neglected.

(b) As soon as the facilities, or the rates of interest, offered by these institutions, make it likely that the monies deposited with them do not represent real savings, but to a large part consist of temporary cash balances, previously held in the form of money in order to buffer the discrepancies between receipts and expenditures, their stimulating influence on the velocity of circulation of money may become important. In that case their activities assume a monetary character.

(c) This will especially be so, when the deposits, received by these institutions, do not come from private persons only, but when the institutions accept corporate deposits also.

(d) A useful indication of the monetary significance of the institutions concerned might be found in the velocity of turnover of their deposits, or of any special group of their deposits. I believe that any yearly velocity of turnover in excess of unity should be looked upon with suspicion.

(e) It must be taken into consideration that any credit structure, based on borrowing short and lending and investing long, is liable to the risk of liquidity crisis. In case of a liquidity crisis it is only the central bank that, as lender of last resort, can offer solace. It would not be reasonable to expect the central bank to assume any responsibility for a rupture in a liquidity setup on which it would never have been able to exert any control.

Question 6:

How adequate do you believe present international financial arrangements are in the light of the size and distribution of international liquidity? To what extent do you believe that present and prospective international financial arrangements inhibit or will inhibit the freedom of individual countries to pursue individual financial policies?

International liquidity

(61) I believe that in the light of the size of available international liquidity present international financial arrangements are adequate, especially as the agreement on borrowing arrangements to the amount of six billion dollars for the International Monetary Fund can now any day become effective.

As I have set forth in the Annual General Meeting of the I.M.F. in Vienna, in September last year, I do not believe that there presently exists a lack of international liquidity. I am rather inclined to think that there is too much liquidity around.

I do not deny that over a somewhat longer period of time the problem of a sufficient supply of international liquidity might arise. We do not know enough, however, about the determinants of the demand for international liquidity in the form of exchange reserves, to be quite sure. Moreover, one can think of many techniques to satisfy such demand if the occasion should arise.

(62) As to the distribution of international liquidity there will, probably, always be reasons for dissatisfaction, since there always will be countries the reserves of which are considered inadequate in

Question 6:

How adequate do you believe present international financial arrangements are in the light of the size and distribution of international liquidity? To what extent do you believe that present and prospective international financial arrangements inhibit or will inhibit the freedom of individual countries to pursue individual financial policies?

International Liquidity

(61) I believe that in the light of the size of available international liquidity present international financial arrangements are adequate, especially as the agreement on borrowing arrangements to the amount of six billion dollars for the International Monetary Fund can now any day become effective.

As I have set forth in the Annual General Meeting of the I.M.F. in Vienna, in September last year, I do not believe that there presently exists a lack of international liquidity. I am rather inclined to think that there is too much liquidity around.

I do not deny that over a somewhat longer period of time the problem of a sufficient supply of international liquidity might arise. We do not know enough, however, about the determinants of the demand for international liquidity in the form of exchange reserves, to be quite sure. Moreover, one can think of many techniques to satisfy such demand if the occasion should arise.

(62) As to the distribution of international liquidity there will, probably, always be reasons for dissatisfaction, since there always will be countries the reserves of which are considered inadequate in

comparison to their needs, calculated on the basis of the fluctuations likely to occur in their balances of payments, increased by some reserve for emergencies.

However, a country can only hold reserves if it can resist the temptations of internal inflationary financing, as the latter will always lead to dissipation of reserves. Since there will, I fear, always be countries that succumb to this temptation there will ever be countries with inadequate reserves.

Of course, a loss of reserves may also be due to other causes than internal inflation. In paragraph (37) I have discussed shifts of demand in international trade as one of these causes. Reserves are then needed to bridge the period of time necessary to carry out the policies that must lead to restoring equilibrium. I believe that in most countries the sum of reserves and available international monetary facilities are adequate to perform that task.

(63) I do not believe that international financial arrangements will inhibit the freedom of individual countries to pursue individual financial policies, provided these policies are not of an inflationary character. If they are, I think that it is rightly the function of international financial arrangements to restrain them. Because if they did not, it would mean that a country could freely spend beyond its means and yet continue to be supplied by the outside world.

comparison to their needs, calculated on the basis of the fluctuations likely to occur in their balances of payments, increased by some reserve for emergencies.

However, a country can only hold reserves if it can resist the temptations of internal inflationary financing, as the latter will always lead to dissipation of reserves. Since there will, I fear, always be countries that succumb to this temptation there will ever be countries with inadequate reserves.

Of course, a loss of reserves may also be due to other causes than internal inflation. In paragraph (37) I have discussed shifts of demand in international trade as one of these causes. Reserves are then needed to bridge the period of time necessary to carry out the policies that must lead to restoring equilibrium. I believe that in most countries the sum of reserves and available international monetary facilities are adequate to perform that task.

(63) I do not believe that international financial arrangements will inhibit the freedom of individual countries to pursue individual financial policies, provided these policies are not of an inflationary character. If they are, I think that it is rightly the function of international financial arrangements to restrain them. Because if they did not, it would mean that a country could freely spend beyond its means and yet continue to be supplied by the outside world.

Present international financial arrangements imply the willingness of participating countries to freely make their currencies available in exchange of gold or dollars at a fixed rate. The possession of foreign exchange reserves, be they in gold or dollars or another reserve currency, therefore implies the power to buy without selling, that is the power to exert an inflationary influence on other countries that have to supply their currency against gold or dollars. Such power must be liable to exhaustion. No country could otherwise submit to it.

The threat of exhaustion of reserves is the ultimate incentive that will rouse countries to pursue the policies that will help to reestablish their external equilibrium. I do not think this should be felt as an inhibition of their freedom. That a country, in the long run, has to live within its means is a matter of course. Freedom lies in the choice of the means to accomplish this end.

Present international financial arrangements imply the willingness of participating countries to freely make their currencies available in exchange of gold or dollars at a fixed rate. The possession of foreign exchange reserves, be they in gold or dollars or another reserve currency, therefore implies the power to buy without selling, that is the power to exert an inflationary influence on other countries that have to supply their currency against gold or dollars. Such power must be liable to exhaustion. No country could otherwise submit to it.

The threat of exhaustion of reserves is the ultimate incentive that will rouse countries to pursue the policies that will help to reestablish their external equilibrium. I do not think this should be felt as an inhibition of their freedom. That a country, in the long run, has to live within its means is a matter of course. Freedom lies in the choice of the means to accomplish this end.

Question 7:

What has the experience in Holland been in maintaining a fixed, rather than a fluctuating, exchange rate, and to what extent has it limited the effectiveness of domestic monetary policy?

Fixed vs fluctuating exchange rates

(64) The Netherlands have never considered to establish a fluctuating exchange rate. In view of the volume of its international trade in proportion to national income and the measure of integration of its economy with that of the neighbouring countries, a fluctuating rate would constitute a very severe obstacle for export industries. In case of an international system of fluctuating rates, the Netherlands, in my opinion, would therefore prefer to seek a fixed parity relationship with one or more of its important trade partners, rather than to fluctuate on its own.

(65) Nevertheless the blessings of maintaining a fixed rate have not been quite unmixed, as is proved by the devaluation of 1949 and the revaluation of 1961.

Yet, both these changes of parity might also be seen as an action to maintain parity with one of the most important trade partners - in the one case the United Kingdom, in the other Germany - the parity with whom, at the moment of decision, was considered more important to maintain than the parity with the rest of the world.

(66) Maintaining a fixed rate has no doubt involved the Netherlands authorities in the dilemmas of monetary policy discussed in the paragraphs 35 and following.

Question 7

What has the experience in Holland been in maintaining a fixed, rather than a fluctuating, exchange rate, and to what extent has it limited the effectiveness of domestic monetary policy?

Fixed vs fluctuating exchange rates

(64) The Netherlands have never considered to establish a fluctuating exchange rate. In view of the volume of its international trade in proportion to national income and the measure of integration of its economy with that of the neighbouring countries, a fluctuating rate would constitute a very severe obstacle for export industries. In case of an international system of fluctuating rates, the Netherlands, in my opinion, would therefore prefer to seek a fixed parity relationship with one or more of its important trade partners, rather than to fluctuate on its own.

(65) Nevertheless the blessings of maintaining a fixed rate have not been quite unmixed, as is proved by the devaluation of 1949 and the revaluation of 1961.

Yet, both these changes of parity might also be seen as an action to maintain parity with one of the most important trade partners - in the one case the United Kingdom, in the other Germany - the parity with whom, at the moment of decision, was considered more important to maintain than the parity with the rest of the world.

(66) Maintaining a fixed rate has no doubt involved the Netherlands authorities in the dilemmas of monetary policy discussed in the paragraphs 35 and follow-

When the difficulties in maintaining parity come from the inside - i.e. when a country is faced with a serious balance of payments deficit due to internal inflationary conditions, or with a surplus due to the prevalence of deflationary factors - they always enhance the effectiveness of monetary policy. Nothing is easier for a central bank than to follow restrictive policies when the banks are anyway drained of liquidity by a balance of payments deficit, or to follow a policy of ease when there are no external worries and the banks are flush.

But it is different when the problems come from the outside and when boom and surplus, or recession and deficit, combine to bedevil the authorities. Under these circumstances the fixed parity no doubt sets a limit to the effectiveness of a monetary policy that would prefer to aim at internal equilibrium only. This, however, is the price that has to be paid for international cooperation. It is also the reason why, these days, all countries are so intensely involved in the internal policies of their major trade partners.

Question 8:

Could you describe for the Commission the nature of the contacts between your bank and the various capital market institutions on the one hand and the public generally on the other hand?

Public relations of the Bank

(67) The main instrument of communication of the Bank with the public generally is the President's Annual Report, a 200 page document, published around the end of the month of April. This report contains a thorough and statistically documented analysis of internal economic and financial developments during the past year, in which the emphasis is laid on the significance of these developments for the internal and external monetary equilibrium. The report explains policy measure the Bank may have taken; it also freely comments on those aspects of Government policy that are believed to have a bearing on that twofold objective with which the Bank in the end concerns itself: viz. the stability of the internal and of the external value of the monetary unit.

The Bank's report gets a great deal of attention in the press. I believe it to have been a factor in helping to keep monetary policy out of political controversy.

(68) Apart from the Annual Report contacts with the general public are of an incidental nature. In periods of great stress, when rather drastic measures had to be taken, I have commented on them in press conferences. The Bank has not found it desirable to institutionalize these contacts, nor has the press asked it to do so.

Question 8:

Could you describe for the Commission the nature of the contacts between your bank and the various capital market institutions on the one hand and the public generally on the other hand?

Public relations of the Bank

(67) The main instrument of communication of the Bank with the public generally is the President's Annual Report, a 200 page document, published around the end of the month of April. This report contains a thorough and statistically documented analysis of internal economic and financial developments during the past year, in which the emphasis is laid on the significance of these developments for the internal and external monetary equilibrium. The report explains policy measure the Bank may have taken; it also freely comments on those aspects of Government policy that are believed to have a bearing on that twofold objective with which the Bank in the end concerns itself: viz. the stability of the internal and of the external value of the monetary unit.

The Bank's report gets a great deal of attention in the press. I believe it to have been a factor in helping to keep monetary policy out of political controversy.

(68) Apart from the Annual Report contacts with the general public are of an incidental nature. In periods of great stress, when rather drastic measures had to be taken, I have commented on them in press conferences. The Bank has not found it desirable to institutionalize these contacts, nor has the press asked

Press communiqués are published occasionally to summarily comment on any measures of importance, such as changes in the discount rate, changes in cash reserve requirements, arrangements with respect to measures of credit restriction, or on important mutations in the Bank's weekly balance sheet.

It is rare that members of the Bank's governing board make public comments on policy matters. Just recently, however, I commented for the first time in a television interview on some points made in the latest Annual Report.

(69) An instrument of indirect public relations, the significance of which should not, in my opinion, be underestimated, consists in the Bank Council.

The Bank Council is a body of seventeen members, created by the Bank Act of 1948, that mainly acts in an advisory capacity to the Minister of Finance in all matters concerning the Bank's monetary policy. It convenes at least six times a year, under the chairmanship of the Bank's Royal Commissioner. The President of the Bank reports to the Bank Council on the general economic and financial situation and on the policies pursued by the Bank.

The important feature of the Bank Council is its composition. Apart from the Royal Commissioner its members are: four members of the Bank's Board of Commissaries, designated by that Board, and twelve members, appointed by the Crown from nominations to be made by designated representative organizations in such

Press communiqués are published occasionally to summarily comment on any measures of importance, such as changes in the discount rate, changes in cash reserve requirements, arrangements with respect to measures of credit restriction, or on important mutations in the Bank's weekly balance sheet.

It is rare that members of the Bank's governing board make public comments on policy matters. Just recently, however, I commented for the first time in a television interview on some points made in the latest Annual Report.

(69) An instrument of indirect public relations, the significance of which should not, in my opinion, be underestimated, consists in the Bank Council.

The Bank Council is a body of seventeen members, created by the Bank Act of 1948, that mainly acts in an advisory capacity to the Minister of Finance in all matters concerning the Bank's monetary policy. It convenes at least six times a year, under the chairmanship of the Bank's Royal Commissioner. The President of the Bank reports to the Bank Council on the general economic and financial situation and on the policies pursued by the Bank.

The important feature of the Bank Council is its composition. Apart from the Royal Commissioner its members are: four members of the Bank's Board of Commissaries, designated by that Board, and twelve members, appointed by the Crown from nominations to be made by designated representative organizations in such

a way that there shall be two representatives each of commerce (inclusive of transport), industry and agriculture; three representatives of the central labour organizations, and three experts on finance and banking.

The Bank Council gives the governing board of the Bank a unique opportunity of explaining ends and means of monetary policy to top-representatives of the economic community. I am happy to say that, for example, the three presidents of the three central labour organizations are presently members of this body.

(70) As to the contacts with financial institutions the Bank entertains, as a matter of course, regular formal contacts with the representative organizations of the commercial banks and of the agricultural credit banks. These contacts are, moreover, necessitated by the provisions of the Act on the Supervision of the Credit System of 1956, which foresee that the Bank shall not make use of its regulatory powers without first having tried to reach agreement with the representative organizations of the banking community. These contacts give, of course, ample opportunity of explaining the aims and of discussing the expected consequences of intended policy measures.

Beside the formal contacts there are frequent informal contacts both with bankers individually and with the daily governing board of the bankers association.

Formal contacts also exist with the

a way that there shall be two representatives each of commerce (inclusive of transport), industry and agriculture; three representatives of the central labour organizations, and three experts on finance and banking.

The Bank Council gives the governing board of the Bank a unique opportunity of explaining ends and means of monetary policy to top-representatives of the economic community. I am happy to say that, for example, the three presidents of the three central labour organizations are presently members of this body.

(70) As to the contacts with financial institution the Bank entertains, as a matter of course, regular formal contacts with the representative organizations of the commercial banks and of the agricultural credit banks. These contacts are, moreover, necessitated by the provisions of the Act on the Supervision of the Credit System of 1956, which foresee that the Bank shall not make use of its regulatory powers without first having tried to reach agreement with the representative organizations of the banking community. These contacts give, of course, ample opportunity of explaining the aims and of discussing the expected consequences of intended policy measures.

Beside the formal contacts there are frequent informal contacts with [illegible] and with the daily governing board of the bankers association.

Formal contacts also exist with the

representative organization of the general savings banks, to which the Bank, in accordance with the above mentioned Act, has delegated, under its authority, the supervision of the general savings banks that are members of this organization.

With other capital market institutions only informal contacts exist. With the representative organizations of the life insurance companies and of the corporate pension funds, arrangements have been made for the quarterly supply of information regarding their operations.

(71) Already since the thirties the Bank has entertained special contacts with higher education by allowing one of the members of its staff, later one of the members of its managing board, to hold an extra-ordinary professorship in the Netherlands School of Economics at Rotterdam. A deputy managing director presently also holds an extraordinary professorship in the faculty of economics of the University of Amsterdam.

I think I may say that these contacts have been mutually advantageous. They have been greatly helpful in bringing central bank thinking in close and reciprocal contact with the academic world.

Amsterdam, 10th August 1962.

(M. W. Holtrop)

representative organization of the general savings banks, to which the Bank, in accordance with the above mentioned Act, has delegated, under its authority, the supervision of the general savings banks that are members of this organization.

With other capital market institutions only informal contacts exist. With the representative organizations of the life insurance companies and of the corporate pension funds, arrangements have been made for the quarterly supply of information regarding their operations.

(71) Already since the thirties the Bank has entertained special contacts with higher education by allowing one of the members of its staff, later one of the members of its managing board, to hold an extra-ordinary professorship in the Netherlands School of Economics at Rotterdam. A deputy managing director presently also holds an extraordinary professorship in the faculty of economics of the University of Amsterdam.

I think I may say that these contacts have been mutually advantageous. They have been greatly helpful in bringing central bank thinking in close and reciprocal contact with the academic world.

Amsterdam, 10th August 1962

(M. W. Holtrop)

Royal Commission
on
Banking and Finance

PROFESSOR LUNDBERG

Hearings
held at
OTTAWA

Vol.	Date.
36	Sept. 12, 1962

Official Reporters
F.J.Nethercut and R.J.Young
Toronto, Ont.

ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,
Ontario, on Wednesday,
September 12th,1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W.A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H.A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

Ottawa, Ontario,
Wednesday,
September 12, 1962.

--- AT 9.20 A.M. THE HEARING RESUMED:

THE CHAIRMAN: I call the meeting to order.

We have present today Professor Erik Lundberg, professor at the University of Stockholm and economic advisor to the Skandinaviska Banken. We appreciate very much your presence with us this morning, Professor Lundberg, and we are looking forward to the discussion which no doubt will take place, and I wish to thank you for devoting so much time in order to be of assistance to us. After the last two or three days I am sure you are familiar with the sort of discussion that is likely to ensue.

PROFESSOR LUNDBERG: Thank you very much, Mr. Chairman. I feel very honoured to be called upon, and I hope I shall be of some slight use to you.

THE CHAIRMAN: Do you prefer to make an opening statement?

PROFESSOR LUNDBERG: No, Mr. Chairman. I have made my submission.

THE CHAIRMAN: We have your submission. We will proceed then with the questions.

COMMISSIONER GIBSON: Mr. Chairman, may I ask a few questions? I have, as the other Commissioners have, read your statement, Professor Lundberg, with a great deal of interest, and I found it stimulating and provocative. One of the ways in which

--- AT 9.20 A.M. THE HEARING RESUMED:

THE CHAIRMAN: I call the meeting to order. We have present today Professor Erik Lundberg, professor at the University of Stockholm and economic advisor to the Skandinaviska Banken. We appreciate very much your presence with us this morning, Professor Lundberg, and we are looking forward to the discussion which no doubt will take place, and I wish to thank you for devoting so much time in order to be of assistance to us. After the last two or three days I am sure you are familiar with the sort of discussion that is likely to ensue.

PROFESSOR LUNDBERG: Thank you very much, Mr. Chairman. I feel very honoured to be called upon, and I hope I shall be of some slight use to you.

THE CHAIRMAN: Do you prefer to make an opening statement?

PROFESSOR LUNDBERG: No, Mr. Chairman, I have made my submission.

THE CHAIRMAN: We have your submission. We will proceed then with the questions.

COMMISSIONER GIBSON: Mr. Chairman, may I ask a few questions? I have, as the other Commissioners have, read your statement, Professor Lundberg, with a great deal of interest, and I found it stimulating and provocative. One of the ways in which

I might start out the discussion would be to ask you something about your views on the objectives of economic policy. You say in your memorandum that there is a fundamental similarity in targets of economic policy as between Sweden and Canada, in that they include full employment, price equilibrium, balance of payments, and stable and rapid economic growth. You point out in your memorandum that

prices have risen a bit more in Sweden than in Canada. You had less of a balance of payments problem, which is very interesting in view of your record in prices. You have had less unemployment and you have had a more stable rate of growth, and a considerably greater rate of growth in the last few years. Now, I take it that it is your view that these differences reflect different conditions, which is certainly the case as we will agree. Would you think to some extent they also reflect a different emphasis of policy?

PROFESSOR LUNDBERG: Yes, I think that is a correct conception of our aims. I have not in my memorandum discussed much of the conflicts between the different targets that have been set up. The only target in Sweden that was set in the 1920's was the target of stability of the price level and that policy target was preserved during the 1930's.

After the war in the preparation for the development during the post-war period -- during the last years of the war -- full employment targets became something new that was taken up as an aim of

I might start [illegible] the discussion would be to ask you something about your views on the objectives of economic policy. You say in your memorandum that there is a fundamental similarity in targets of economic policy as between Sweden and Canada, in that they include full employment, price equilibrium, balance of payments, and stable and rapid economic growth. You point out in your memorandum that prices have risen a bit more in Sweden than in Canada. You had less of a balance of payment's problem, which is very interesting in view of your record in prices. You have had less unemployment and you have had a more stable rate of growth, and a considerably greater rate of growth in the last few years. Now, I take it that it is your view that these differences reflect different conditions, which is certainly the case as we will agree. Would you think to some extent they also reflect a different emphasis of policy?

PROFESSOR LINDBECK: Yes, I think that is a correct conception of our aims. I have not in my memorandum discussed much of the conflicts between the different targets that have been set up. The only target in Sweden that was set in the 1920's was the target of stability of the price level and that policy target was preserved during the 1930's.

After the war in the preparation for the development during the post-war period -- during the last years of the war -- full employment targets

very high priority. Then the stability of the price level was taken seriously, too, but as I understand the discussion, full employment became the priority aim -- the highest priority. The Swedish government could not tolerate any unemployment, or, at least, unemployment of the type we had during the 1920's and the 1930's.

A little later growth problems became common all over the world. It was more or less implicit in the reasoning that if you aim at high or full employment and you have industrial development then growth follows more or less automatically. As I say in my memorandum, we have had less anxiety about growth than most other countries. There has not been any serious criticism of the policy of the government to the effect that it has retarded growth, as, for instance, there has been in the United Kingdom. How we emphasize the different targets of policy is determined by the different kinds of situations we run into.

The unemployment prospects at the end of the war made it appear that full employment or high employment should be a primary aim of economic policy during the first years of the post-war period. As in many other countries, brilliant economists forcasted a great depression after the end of the war, so we, as did many other countries, prepared to meet that depression and see to it that this unemployment would not occur. High employment or full employment became of the highest priority, and the price level from that point

very high priority. Then the stability of the price level was taken seriously, too, but as I understand the discussion, full employment became the priority aim -- the highest priority. The Swedish government could not tolerate any unemployment, or, at least, unemployment of the type we had during the 1920's and the 1930's.

A little later growth problems became common all over the world. It was more or less implicit in the reasoning that if you aim at high or full employment and you have industrial development then growth follows more or less automatically. As I say in my memorandum, we have had less anxiety about growth than most other countries. There has not been any serious criticism of the policy of the government to the effect that it has retarded growth, as, for instance, there has been in the United Kingdom. How we emphasize the different targets of policy is determined by the different kinds of situations we run into.

The unemployment prospects at the end of the war made it appear that full employment or high employment should be a primary aim of economic policy during the first years of the post-war period. As in many other countries, brilliant economists forecasted a great depression after the end of the war, so we, as did many other countries, prepared to meet that depression and see to it that this unemployment would not occur. High employment or full employment became of the highest priority, and the price level from that point

of view became of secondary importance because if there are prospects of a depression then the price level will take care of itself.

COMMISSIONER GIBSON: Would you say the emphasis changes as a result of fifteen years of very high employment and rising prices?

PROFESSOR LUNDBERG: Yes, I would say that is correct, because the priority emphasis that we give is very much determined by the current problems and the forecast about the future.

During the time from, say, the Korean crisis, there has been much criticism of the government for not carrying out a policy for the stabilization of the price level, but because we have followed an energetic policy directed towards full employment the stabilization of the price level has been neglected. This stabilization has not been taken as a severe problem, and therefore the policy discussions and the criticism of the government -- not least from the side of the economists -- has been directed towards its policy of stabilizing the price level.

In general political discussions there have been strong orations about the importance of stabilizing money and things like that, but when we come to matters of fact and the government has to deal with the pressure groups in an economy like that of Sweden then this problem of the price level is always very much pushed into the background.

Problems have to be solved, and the way of solving severe problems in regard to income distribution,

of view became of secondary importance because if there are prospects of a depression then the price level will take care of itself.

COMMISSIONER GIBSON: Would you say the emphasis changes as a result of fifteen years of very high employment and rising prices?

PROFESSOR LUNDBERG: Yes, I would say that is correct, because the priority emphasis that we give is very much determined by the current problems and the forecast about the future.

[illegible] there has been much criticism of the government for not carrying out a policy for the stabilization of the price level, but because we have followed an energetic policy directed towards full employment the stabilization of the price level has been neglected. This stabilization has not been taken as a severe problem, and therefore the policy discussions and the criticism of the government -- not least from the side of the economists -- has been directed towards its policy of stabilizing the price level.

In general political discussions there have been strong orations about the importance of stabilizing money and things like that, but when we come to matters of fact and the government has to deal with the pressure groups in an economy like that of Sweden then this [illegible]

Problems have to be solved, and the way of solving severe problems in regard to income distribution,

and problems with respect to management, in general tend to go in an inflationary direction. With the lips one confesses that price stability is very important, but when one gets down to actual behavior and policy then it does not get that kind of high priority.

I do not think we are unique in this respect. The stabilization of the value of money is a high priority aim, and we confess ourselves to that aim, but in the actual practical procedures of solving current problems of the economy the price level problem has necessarily to be put in the background. On the other hand, we always hope that more attention will be paid to it than has been paid to it during most of the post war period.

Thanks to the general international surroundings of Sweden and especially the fall in raw material prices, and more balanced world markets, during the last few years the price level in Sweden has become more stable. I do not think that is an effect primarily of government policy, but is the effect of export and import prices being more stable than they have been during the first ten or fifteen years of the post-war period. On the other hand, you can always say that you can imagine such mismanagement of policy on the part of the government, so in spite of stable world market prices there had occurred internal inflation in Sweden. From this point of view the government policy of stabilization was relatively successful.

I think, in answer to your question, that the problem of stabilizing the value of money has

and problems with respect to management, in general tend to go in an inflationary direction. With the lips one confesses that price stability is very important, but when one gets down to actual behavior and policy then it does not get that kind of high priority.

I do not think we are unique in this respect. The stabilization of the value of money is a high priority aim, and we confess ourselves to that aim, but in the actual practical procedures of solving current problems of the economy the price level problem has necessarily to be put in the background. On the other hand, we always hope that more attention will be paid to it than has been paid to it during most of the post war period.

[illegible]

surroundings of Sweden and especially the fall in raw material prices, and more balanced world markets, during the last few years the price level in Sweden has become more stable. I do not think that is an effect primarily of government policy, but is the effect of export and import prices being more stable than they have been during the first ten or fifteen years of the post war period. On the other hand, you can always say that you can imagine such mismanagement of policy on the part of the
in spite of
government, [illegible] occurred internal inflation in Sweden. From this point of view the government policy of stabilization was [illegible]

I think, in answer to your question, that the problem of stabilizing the value of money has

always been considered in the discussions. It has been an aim or a target of high priority, but in the actual deeds and in the actual policies carried out it has been more or less neglected.

COMMISSIONER GIBSON: Do you make a distinction in setting objectives in Sweden between what are the objectives of economic policy and what are the objectives of monetary policy? In other words, would you have a narrower field of targets for monetary policy than you would have for your general economic policy?

PROFESSOR LUNDBERG: No, not nowadays. There was a time when it was supposed -- that was especially the fact during the 1930's, and perhaps in some quarters after the war -- that monetary policy -- I am referring to the policy of the central bank especially -- referred especially to the price level. That was an old tradition. It was also supposed that fiscal policy and other policy measures referred to employment and growth.

During the last ten years, anyhow, there has been no question of making a division as between the policy measures towards achieving stabilization of the value of money, and those policy measures especially directed to other targets. We take the whole arsenal of policy weapons as a unit, more or less, and we try to discuss the effects of the whole conglomerate of policy measures on these different targets.

COMMISSIONER GIBSON: This implies a high

[illegible]

been an aim or a target of high priority, but in the actual deeds and in the actual policies carried out it has been more or less neglected.

COMMISSIONER GIBSON: Do you make a distinction in setting objectives in Sweden between what are the objectives of economic policy and what are the objectives of monetary policy? In other words, would you have a narrower field of targets for monetary policy than you would have for your general economic policy?

[illegible]

There was a time when it was supposed -- that was especially the fact during the 1930's, and perhaps in some quarters after the war -- that monetary policy -- I am referring to the policy of the central bank especially -- referred especially to the price level. That was an old tradition. It was also supposed that fiscal policy and other policy measures referred to employment and growth.

During the last ten years, anyhow, there has been no question of making a division as between the policy measures towards achieving stabilization of the value of money, and those policy measures especially directed to other targets. We take the whole arsenal of policy weapons as a unit, more or less, and we try to discuss the effects of the whole conglomerate of policy measures on these different targets.

COMMISSIONER GIBSON: This implies a high

degree of co-ordination, but I think we will be asking you questions about that later on in regard to central bank relations with government, and so on. Would you care to say a word or two about how Sweden can achieve equilibrium in her balance of payments with a substantial average annual price increase? This seems like quite a remarkable achievement.

PROFESSOR LUNDBERG: Yes. As I say in my memo, it is a problem. I think it is easier to explain how and why a country gets into an exchange crisis, and more difficult to explain why it does not, because exports and imports are just marginal parts of the whole development of the economy.

For example, since 1950, or over the past twelve years, the value of Swedish imports has increased by about four times in terms of value. That is partly a consequence of the rise in prices, and also a consequence of the fact that volume of imports tends to rise more rapidly than the real gross national product. There is a rather high marginal propensity to import. During this period of full employment our real national income has been rising by about 3 - 4 per cent per year but volume of imports have tended to rise by about 40 per cent more. There is a clear tendency for imports to rise more rapidly than the national income. So, if you have an increase in value of imports of 400 per cent it must be very much a matter of luck that export values have increased about four times also. There is a mechanism of some kind that sees to it that this happens. If it

degree of co-ordination, but I think we will be asking you questions about that later on in regard to central bank relations with government, and so on. Would you care to say a word or two about how Sweden can achieve equilibrium in its balance of payments with a substantial average annual price increase? This seems like quite a remarkable achievement.

PROFESSOR LUNDBERG: Yes. As I say in my memo, it is a problem. I think it is easier to explain how and why a country gets into an exchange crisis, and more difficult to explain why it does not, because exports and imports are just marginal parts of the whole development of the economy.

For example, since 1950, or over the past twelve years, the value of Swedish imports has increased by about four times in terms of value. That is partly a consequence of the rise in prices, and also a consequence of the fact that volume of imports tends to rise more rapidly than the real gross national product. There is a rather high marginal propensity to import. During this period of full employment our real national income has been rising by about 3 - 4 per cent per year but volume of imports have tended to rise by about 40 per cent more. There is a clear tendency for imports to rise more rapidly than the national income. So, if you have an increase in value of imports of 400 per cent it must be very much a matter of luck that export values have increased about four times also. There is a mechanism of some kind that sees to it that this happens. If it

did not happen we would have had exchange crises.

There is a great difference between Canada and Sweden in that Sweden has a big plus in its income from shipping. Shipping is a big plus item in our balance of payment and it also has increased by about four times. So, over this period the current balance of payments has just evened out with some surplus.

I don't consider this as an effect of very good policy, it is partly good luck. When you look at Swedish exports, and we have been studying them rather closely -- and here I refer to shipping and engineering products such as telephones, machines of all kinds, electrical equipment and refined steel products -- you find that demand for such products in Western Europe, and in most of the world has high income elasticity. When compared with the industrial production of the O.E.C.D. countries we find that an increase by one percent of production is accompanied by an increase in demand for Swedish exported products of this kind by 1.4 per cent. That is what we call an income elasticity of 1.4. So, the demand for these products increased 40 per cent more rapidly than production in these countries. The explanation of why the value of Swedish exports has risen more quickly than national income has reference to this part of our exports with a very high income elasticity.

COMMISSIONER GIBSON: In other words, your machinery exports have been very much in demand lately -- more so than your basic raw materials.

[illegible] happen we would have had exchange crises.

There is a [illegible]

and Sweden in that Sweden has a big plus in its income from shipping. Shipping is a big plus item to our balance of payment and it also has increased by about four times. So, over this period the current balance of payments has just evened out with some surplus.

I don't consider this as an effect of very good policy, it is partly good luck. When you look at Swedish exports, and we have been studying them rather closely -- and here I refer to shipping and engineering products such as telephones, machines of all kinds, electrical equipment and refined steel products -- you find that demand for such products in Western Europe, and in most of the world has high income elasticity. When compared with the industrial production of the O.E.C.D. countries we find that an increase by one percent of production is accompanied by an increase in demand for Swedish exported products of this kind by 1.4 per cent. That is what we call an income elasticity of 1.4. So, the demand for these products increased 40 per cent more rapidly [illegible]

of why the value of Swedish exports has risen more quickly than national income has reference to this part of our exports with a very high income elasticity.

COMMISSIONER GIBSON: In other words, your machinery exports have been very much in demand lately -- more so than your basic raw materials.

PROFESSOR LUNDBERG: Yes. There is also iron ore. Up to the last few years there has been a high elasticity of demand in this field also. It has been responding very much, and so has wood products such as paper and pulp up to the last few years. There is now some stagnation of demand in that field. With regard to textile products we have also had some expansion of exports. It is only in timber goods and agricultural products that the demand has been slight.

COMMISSIONER GIBSON: Getting back to objectives again, do you think there is any essential conflict between high employment and stable prices?

PROFESSOR LUNDBERG: Yes, I do. We are certainly very much aware that there is a clear clash of objectives here. Of course, our prime minister and finance minister can talk about these conflicts in such a way that you will not recognize them. But they are certainly very much aware of such conflicts.

The background of this is, of course, that when we in Sweden have full employment or high employment with, say, one per cent unemployment -- such a situation really means an excess demand for labour in many fields of the economy, so that we have more vacancies than job seekers. In the growth industries especially there is a great pressure for more workers, especially skilled workers. As we have a piece-rate system of wage payments to a greater extent than other countries this means that new piece-

PROFESSOR LUNDBERG: Yes. There is also iron ore. Up to the last few years there has been a high elasticity of demand in this field also. It has been responding very much, and so has wood products such as paper and pulp up to the last few years. There is now some stagnation of demand in that field. With regard to textile products we have also had some expansion of exports. It is only in timber goods and agricultural products that the demand has been slight.

objectives again, do you think there is any essential conflict between high employment and stable

PROFESSOR LUNDBERG: Yes, I do. We are certainly very much aware that there is a clear clash of objectives here. Of course, our prime minister and finance minister can talk about these conflicts in such a way that you will not recognize them. But they are certainly very much aware of such conflicts.

The background of this is, of course, that when we in Sweden have full employment or high employment with, say, one per cent unemployment -- such a situation really means an excess demand for labour in many fields of the economy, so that we have more vacancies than job seekers. In the growth industries especially there is a great pressure for more workers, especially skilled workers. As we have a piece-rate system of wage payments to a greater other countries this means that new piece-

rates have to be worked out more or less continuously on the spot in these engineering shops. There is a high demand for skilled labour, and there is competition between the corporations so that when new machinery with higher productivity is installed labour gets a large part of the benefit. This process brings about what we call a wage slide going on under these conditions.

Such wage slides contribute to the rapid increase in wages under full employment and are transmitted also to time rate workers and other branches of activity. Sweden has an almost perfectly organized economy. There is hardly any single citizen in our country who does not belong to some kind of organized group, a trade union, an employers' organization or a farmers' union, and all these groups see to it that the income of their members does not lag behind the general development.

The result from this type of full employment is thus a strong pressure for rising incomes coming from rising wages in the growth industries and transmitted over the economy.

COMMISSIONER GIBSON: That is partly how you define full employment. When you said one per cent, you said this was over-full employment?

PROFESSOR LUNDBERG: Yes, in important sectors of the economy. But there are always people going away from one job to another. There are always at the same time sectors of the economy and corporations that cannot expand or stagnate and release workers being unemployed for a time; and the one per cent is as a result of the process.

COMMISSIONER GIBSON: The full employment percentage, would it be as much as 3 per cent unemployment?

PROFESSOR LUNDBERG: No. There are degrees, of course.

COMMISSIONER GIBSON: As a reasonable target, a figure over which you should be concerned?

PROFESSOR LUNDBERG: As I said in my memo, when we experienced the recession in 1958-59, during the winter-time we reached about 4 per cent, and that was considered very bad. The government really got a feel of the strong reaction from labour, from the trade union people. Even the Liberal and Conservative parties took the opportunity of criticizing the government for lags in policy. As I say, that was during the winter-time, where there is always some seasonal slack.

What I would like to add is that during the

The result from this type of full employment is thus a strong pressure for rising incomes coming from rising wages in the growth industries and transmitted over the economy.

COMMISSIONER [illegible] you define full employment. When you said one per cent, you said this was over-full employment?

PROFESSOR LUNDBERG: Yes, in important sectors of the economy. But there are always people going away from one job to another. There are always at the same time sectors of the economy and corporations that cannot expand or stagnate and release workers being unemployed for a time; and the one per cent is as a result of the [illegible]

COMMISSIONER GIBSON: The full employment percentage, would it be as much as 3 per cent unemployment?

PROFESSOR LUNDBERG: [illegible]

COMMISSIONER GIBSON: As a reasonable target, a figure over which you should be concerned?

PROFESSOR LUNDBERG: As I said in my memo, when we experienced the recession in 1958-59, during the winter-time we reached about 4 per cent, and that was considered very bad. The government really got a feel of the strong reaction from labour, from the trade union people. Even the Liberal and Conservative parties took the opportunity of criticizing the government for lags in policy. As I say, that was during the winter-time, where there is always some seasonal slack.

What I would like to add is that during the

recessions we have had, in 1954, 1958 - 1959 --- when we had unemployment up to 4 per cent -- then the rate of increase of wages was slower and the price level increase was down to one per cent per year, or something like that. So that we can see a clear relationship between degree of full employment and wage and price development. That is to say, if we tolerated 4 per cent unemployment and we could pay the unemployed reasonably well, so there was not too much dissatisfaction, then we would perhaps be able to stabilize the price level.

COMMISSIONER GIBSON: You would not feel, in those circumstances, with a 4 per cent unemployment rate, there was nearly the same conflict? As you know, there has been quite a lot of talk to the effect that full employment and price stability are not in conflict, but most of that kind of thinking has been revolving around unemployment being not more than 4 per cent -- this sort of percentage.

PROFESSOR LUNDBERG: I agree that the conflict would not be so apparent at that level in Sweden if that unemployment rate was accepted as sufficiently low. I do not know what would be the result in this counrty. This degree of full employment -- and you must speak of degrees here -- is not the only factor however. We have noticed that during periods when there is very hard competition in the export field as to imports to Sweden then the possitilities and the powers of resistance against demands for wage increases of employers are much stronger than in periods of international inflation.

[illegible]

we had unemployment up to 4 per cent -- then the rate of increase of wages was slower and the price level increase was down to one per cent per year, or something like that. So that we can see a clear relationship between degree of full employment and wage and price development. That is to say, if we tolerated 4 per cent unemployment and we could pay the unemployed reasonably well, so there was not too much dissatisfaction, then we would perhaps be able to stabilize the price level.

COMMISSIONER GIBSON: You would not feel, in those circumstances, with a 4 per cent unemployment rate, there was nearly the same conflict? As you know, there has been quite a lot of talk to the effect that full employment and price stability are not in conflict, but most of that kind of thinking has been revolving around unemployment being not more than 4 per cent -- this sort of percentage.

PROFESSOR LUNDBERG: I agree that the conflict would not be so apparent at that level in Sweden if that unemployment rate was accepted as sufficiently low. I do not know what would be the result in this country. This degree of full employment -- and you must speak of degrees here -- is not the only factor however. We have noticed that during periods when there is very hard competition in the export field as to imports to Sweden then the possibilities and the powers of resistance against demands for wage increases of employers are much stronger

[illegible]

On occasions during the last few years the export employers' association has put up much of such resistance, because they knew, or thought they knew, they could not really compensate themselves for higher wage costs under the world competition conditions. The trade union people are also aware of such difficulties. The engineering industry is, to a large extent, an export industry; about one-third of production is exported. The export industries will be very much influenced by the fact that they have or will have difficulties in selling their products, and they therefore must put up strong resistance to wage pressure. You can have full employment even under such conditions, when the world market is not inviting to inflation.

As a contrast, I may tell you what happened when the opposite conditions prevailed during the Korean crisis. It was said that our trade unions behaved responsibily when faced with this situation. At the end of 1950, when the Korean boom was going on,the trade union economists made a forecast -- I think it was quite reasonable -- that the cost of living in Sweden would rise by about 10 per cent during 1951. The trade union economists maintained that such a rise of consumer prices was not something that they had to carry. The Swedish economy was prosperous and the terms of trade were rising rapidly as well as productivity. From this point of view there was no reason why the workers should be punished, and have lower real wages, because of expected price increase. The origin of the rising cost of living came from abroad in the form of rising import and

On occasions during the last few years the export employers' association has put up much of such resistance, because they knew, or thought they knew, they could not really compensate themselves for higher wage costs under the world competition conditions. The trade union people are also aware of such difficulties. The engineering industry is, to a large extent, an export industry; about one-third of production is exported. The export industries will be very much influenced by the fact that they have or will have difficulties in selling their products, and they therefore must put up strong resistance to wage pressure. You can have full employment even under such conditions, when the world market is not inviting to inflation.

As a contrast, I may tell you what happened when the opposite conditions prevailed during the Korean crisis. It was said that our trade unions behaved responsibly when faced with this situation. At the end of 1950, when the Korean boom was going on, the trade union economists made a forecast -- I think it was quite reasonable -- that the cost of living in Sweden would rise by about 10 per cent during 1951. The trade union economists maintained that such a rise of consumer prices was not something that they had to carry. The Swedish economy was prosperous and the terms of trade were rising rapidly as well as productivity. From this point of view there was no reason why the workers should be punished, and have lower real wages, because of expected price increase. The origin of the rising cost of living came from abroad in the form of rising import and

export prices. The problem was to calculate how much increase in wage rates was necessary in order to compensate for the expected rise of consumer prices. The calculators wanted to find out what increase in wages would be necessary to give the workers, in general, an increase of real wages after taxes -- something comparable to the expected increase in productivity of the Swedish economy. In order to do that they had also to find out what would be the repercussions of the increased wages on the price level. It was just to put down an equation, and solve it to find out what should be a reasonable increase of wage rates, to give workers a real wage increase corresponding to about four per cent. In actual fact the result was about 20 per cent increase of wages, and in this way the workers just hardly covered the actual increase in cost of living.

Under these conditions the unions carried out a responsible wage policy and the entrepreneurs put up very little resistance -- because the export boom was tremendous, particularly with regard to wood and pulp products. So we had two years of a rise of over 20 per cent per year in wages -- -- in 1951 and 1952 -- with only a moderate rise in real wages as a result.

In contrast to this situation we have had no inflationary impulses from abroad in the last few years, when exports were not booming, and when from Japan, Western Germany and also the East there was very heavy competition in many fields. Then the exporters' association will put up a very heavy resistance, even when there is full employment, and the wage rise will

export prices. The problem was to calculate how much increase in wage rates was necessary in order to compensate for the expected rise of consumer prices. The calculators wanted to find out what increase in wages would be necessary to give the workers, in general, an increase of real wages after taxes -- something comparable to the expected increase in productivity of the Swedish economy. In order to do that they had also to find out what would be the repercussions of the increased wages on the price level. It was just to put down an equation and solve it to find out what should be a reasonable increase of wage rates, to give workers a real wage increase corresponding to about four per cent. In actual fact the result was about 20 per cent increase of wages, and in this way the workers just barely covered the actual increase in cost of living.

[illegible] a responsible wage policy and the entrepreneurs put up very little resistance -- because the export boom was tremendous, particularly with regard to wood and pulp products. So we had two years of a rise of over 20 per cent per year in wages -- -- in 1951 and 1952 -- with only a moderate rise in real wages as a result.

In contrast to this situation we have had no inflationary impulses from abroad in the last few years, when exports were not booming, and when from Japan, Western Germany and also the East there was very heavy competition in many fields. Then the exporters' association will put up a very heavy resistance, even when there is full employment, and the wage rise will

be dampened. This means that it is a question of the degree of employment, but also the general international situation which determines the development of Swedish wages and prices.

COMMISSIONER GIBSON: Would you care to put any quantitative measures on what are appropriate objectives of economic policy? In other words, when you talk about employment and you talk about a one per cent unemployment rate, and there has been some reference to 4 per cent, what is a tolerable maximum level of employment as a national objective? What is a tolerable annual price increase? Would you care to say anything along those lines? What is a desired growth rate? This is a way of sort of putting priorities on objectives, if you like.

PROFESSOR LUNDBERG: These are really hard questions.

COMMISSIONER GIBSON: I know.

PROFESSOR LUNDBERG: I do not know how interesting my answers would be, because I am just an irresponsible, single professor. It would be much more interesting to have the pronouncement from a central bank head -- although he would not answer, perhaps. But I would like to take up your question from the point of view that, first, when you asked for what I would consider a reasonable rate or a target for full employment, that question has to be answered from the point of view of what kind of labour market policy is being carried out in the country. I have written a little about that in the memo. Economic development

be dampened. This means that it is a question of the degree of employment, but also the general international [illegible] wages and prices.

COMMISSIONER GIBSON: Would you care to put any quantitative measures on what are appropriate objectives of economic policy? In other words, when you talk about employment and you talk about a one per cent unemployment rate, and there has been some reference to 4 per cent, what is a tolerable maximum level of employment as a national objective? What is a tolerable annual price increase? Would you care to say anything along those lines? What is a desired growth rate? This is a way of sort of putting priorities on objectives, if you like.

PROFESSOR LUNDBERG. These are really hard [illegible].

[illegible]

PROFESSOR LUNDBERG: I do not know how interesting my answers would be, because I am just an irresponsible, single professor. It would be much more interesting to have the pronouncement from a central bank head -- although he would not answer, perhaps. But I would like to take up your question from the point of view that, first, when you asked for what I would consider a reasonable rate or a target for full employment, that question has to be answered from the point of view of what kind of labour market policy is being carried out in the country. I have written a little about that in the memo. Economic development

is always uneven. If you look at the growth of the total economy you will find that most of the growth is determined by a minority of corporations and firms and branches of activity. It is those growing and rapidly growing branches of activity being far above the average, that carry the economy forward. So the unevenness of growth means that there are branches of activity that are rapidly expanding the demand for labour; and there are, on the other side, industries that are stagnating and pushing labour out of employment. So the tolerance of unemployment you could have very much depends on the mobility of labour and other resources. If you imagine an ideal labour market policy, where we have effective labour exchanges making people able to move very quickly and find housing accommodation in the places where growth occurs, then you can always see to it that these branches of the economy which are expanding rapidly are continuously fed with new labour from contracting industries. Under such ideal conditions you can carry out a policy with a very low rate of unemployment -- below one per cent and close to zero, if the policy were perfect. But if you have long distances in the country and low efficiency in labour market policy and coal mining in the country -- and I think that is one of the happy states of the Swedish economy, that we have no coal mines -- then you get a sluggish mobility. In the stagnating industries people will not and do not move and do not like to be trained in new skills, and so on. If you have a policy that does not help very much in people

is always uneven. If you look at the growth of the total economy you will find that most of the growth is determined by a minority of corporations and firms and branches of activity. It is those growing and rapidly growing branches of activity being far above the average, that carry the economy forward. So the unevenness of growth means that there are branches of activity that are rapidly expanding the demand for labour; and there are, on the other side, industries that are stagnating and pushing labour out of employment. So the tolerance of unemployment you could have very much depends on the mobility of labour and other resources. If you imagine an ideal labour market policy, where we have effective labour exchanges making people able to move very quickly and find housing accommodation in the places where growth occurs, then you can always see to it that these branches of the economy which are expanding rapidly are continuously fed with new labour from contracting industries. Under such ideal conditions you can carry out a policy with a very low rate of unemployment -- below one per cent and close to zero, if the policy were perfect. But if you have long distances in the country and low efficiency in labour market policy and coal mining in the country -- and I think that is one of the happy states of the Swedish economy, that we have no coal mines -- then you get a sluggish mobility. In the stagnating industries people will not and do not move and do not like to be trained in new skills, and so on. If you have a policy that does not help very much in people

moving from contracting to expanding industries, then the excess demand from the developing industries may be dangerous and inflationary, and you have to tolerate a much higher rate of unemployment in order to avoid inflation.

So, I would answer your question with an answer that is typically professorial, by complicating the problem and referring it to such other factors. But in the Swedish economy we aim at making or creating a labour market policy, improving it to such an extent resulting in such high mobility of labour and vocational training, that we would be able to keep the unemployment rate at one or one and a half per cent without danger of too much wage pressure.

It is quite interesting to note that in the autumn, by policy measures, the Swedish have created a building boom, especially in the south and middle south of Sweden with a great excess demand for labour. But the labour market board now tries, and is quite effective in transferring workers from the north -- where there is somewhat of a depressed state because of the difficulties of the forest industries, the transference of workers especially refers to those people being skilled in building. If there is a building boom at a certain place in Sweden, with great scarcity of workers, then 50 or 100 building workers coming from the north will make a very great difference from the point of view of production and the determination of piece rates.

This policy of mobility, I think, really helps

moving from contracting to expanding industries, then [illegible] dangerous and inflationary, and you have to tolerate a much higher rate of unemployment in order to avoid inflation.

So, I would answer your question with an answer that is typically professorial, by complicating the problem and referring it to such other factors. But in the Swedish economy we aim at making or creating a labour market policy, improving it to such an extent resulting in such high mobility of labour and vocational training, that we would be able to keep the unemployment rate at one or one and a half per cent without danger of too much wage pressure.

It is quite interesting to note that in the autumn, by policy measures, the Swedish have created a building boom, especially in the south and middle south of Sweden with a great excess demand for labour. But the labour market board now tries, and is quite effective in transferring workers from the north -- where there is somewhat of a depressed state because of the difficulties of the forest industries, the transference of workers especially refers to those people being skilled in building. If there is a building boom at a certain place in Sweden, with great scarcity of workers, then 50 or 100 building workers coming from the north will make a very great difference from the point of view of production and the determination of [illegible]

This policy of mobility, I think, really helps

us in keeping a higher target for employment than otherwise would be the case. So I put my answer to the question in this way -- but it cannot be given a quantitative precision from this point of view as my answer is relating to the mobility of labour. We think that one per cent unemployment is what we should aim at and try to keep. We are aware of the fact that such a high ambition often mean a too rapid wage increase. We have, at that employment level, with current degree of mobility, admitted that we can stand a general price increase of one to two per cent a year. That is an improvement in price stabilization to what we had before.

COMMISSIONER GIBSON: You regard that as a tolerable level?

PROFESSOR LUNDBERG: Yes, I regard that as a tolerable level. We think it is bad in a way, but it has to be related to the badness of having more unemployment, and this degree of devaluation of the value of money is not supposed to be too bad. We have higher rates of interest than earlier, when we kept a 3 or 3½ per cent long-term rate of interest. At a rate of increase of prices of 4 per cent, people having insurance policies and deposits at the bank had during those years a negative rate of interest. But now we have 5 or 5½ per cent on long term bonds, and having an increase of one or two per cent in the price level in the longer run. It is a tremendous improvement, if you look at the real yield for people saving money.

us in keeping a higher target for employment than otherwise would be the case. So I put my answer to the question in this way -- but it cannot be given a quantitative precision from this point of view as my answer is relating to the mobility of labour. We think that one per cent unemployment is what we should aim at and try to keep. We are aware of the fact that such a high ambition often mean a too rapid wage increase. We have, at that employment level, with current degree of mobility, admitted that we can stand a general price increase of one to two per cent a year. That is an improvement in price stabilization to what we had before.

COMMISSIONER GIBSON: You regard that as a tolerable level?

PROFESSOR LUNDBERG: Yes, I regard that as a tolerable level. We think it is bad in a way, but it has to be related to the badness of having more unemployment, and this degree of devaluation of the value of money is not supposed to be too bad. We have higher rates of interest than earlier, when we kept a 3 or 3½ per cent long-term rate of interest. At a rate of increase of prices of 4 per cent, people having insurance policies and deposits at the bank had during those years a negative rate of interest. But now we have 5 or 5½ per cent on long term bonds, and having an increase of one or two per cent in the price level in [illegible] you look at the real yield for people saving money.

COMMISSIONER GIBSON: Is there an increased disposition to save when it is fixed so high?

PROFESSOR LUNDBERG: Yes, we think so. We have a rather high marginal propensity to save.

THE CHAIRMAN: In spite of an inflationary trend it does not make any difference, or dies it affect the interest rate on the long-term securities?

PROFESSOR LUNDBERG: Yes, from the policy point of view it can be said that we have adjusted our rate of interest level to the fact that we expect a decline in the value of money in the long run. Very few people do really suffer from this. That is the problem, that you cannot get a pressure interest group saying, "We are the real sufferers because of this deterioration of the value of money," since wage earners are only very partly sufferers when they have money in the bank and in insurance policies. They may gain more by the rapid increase in wages. Nearly everybody is divided, more or less, between having some savings on the one hand and, on the other hand, current wage incomes. We have tried to estimate who suffers from inflations, and there is no clearly defined large group that carries the burden. Even the pensioners are to a considerable extent nowadays guarded against the deterioration of the value of money. It is the danger that few have any strong reason to put up resistance against the deterioration of the value of money. The really strong reason is that we might not survive in international competition and therefore get into balance of payment problems in the long run.

COMMISSIONER GIBSON: Is there an increased disposition to save when it is fixed so high?

PROFESSOR LUNDBERG: Yes, we think so. We have a rather high marginal propensity to save.

THE CHAIRMAN: In spite of an inflationary trend it does not make any difference, or dies it affect the interest rate on the long-term securities?

PROFESSOR LUNDBERG: Yes, from the policy point of view it can be said that we have adjusted our rate of interest level to the fact that we expect a decline in the value of money in the long run. Very few people do really suffer from this. That is the problem, that you cannot get a pressure interest group saying, "We are the real sufferers because of this deterioration of the value of money," since wage earners are only very partly sufferers when they have money in the bank and in insurance policies. They may gain more by the rapid increase in wages. Nearly everybody is divided, more or less, between having some savings on the one hand and, on the other hand, current wage incomes. We have tried to estimate who suffers from inflations, and there is no clearly defined large group that carries the burden. Even the pensioners are to a considerable extent nowadays guarded against the deterioration of the value of money. It is the danger that few have any strong reason to put up resistance against the deterioration of the value of money. [illegible] get into balance of payment problems in the long run.

That is the clear reason for resistance for the government, and the employers and trade unions understand that too. If we go too far and have too rapid an increase in price and wage levels we will come into difficulty in the balance of payments. On the other hand during the last years Germany, Holland and some other countries are nowadays "better" thatn we are at devaluing money.

THE CHAIRMAN: Before we get on to some other aspect of this, when you fix a percentage of, say, 4 per cent or 1½ per cent or 2 per cent, or whatever it may be, as to unemployment, in order to obtain a clear and accurate idea of what that means we have to know something about the statistical base for that. That is, when is a person statistically unemployed, and for how long is he unemployed, and so on? If you compare the 4 per cent in Sweden with 4 per cent in Canada it may be that the statistical base in the two countries is different and you cannot therefore very well compare them.

That is the clear reason for the government, and the employers and trade unions understand that too. If we go too far and have too rapid an increase in price and wage levels we will come into difficulty in the balance of payments. On the other hand during the last years Germany, Holland and some other countries are nowadays "better" than we are at devaluing money.

THE CHAIRMAN: Before we get on to some other aspect of this, when you fix a percentage of, say, 4 per cent or 1½ per cent or 2 per cent, or whatever it may be, as to unemployment, in order to obtain a clear and accurate idea of what that means we have to know something about the statistical base for that. That is, when is a person statistically unemployed, and for how long is he unemployed, and so on? If you compare the 4 per cent in Sweden with 4 per cent in Canada it may be that the statistical base in the two countries is different and you cannot therefore very well compare them.

PROFESSOR LUNDBERG: This is a very important aspect of thisproblem, of course, the measurement of unemployment is a very difficult problem, and a definition of what is "unemployment" is not easy. Previously we referred our unemployment rates to the rates of the insured workers, but nowadays we have also labour force investigations along the American methods. We do that twice a year, and have definitions very close to the American ones, and I presume it is almost the same as in Canada. According to the last labour force investigations relating to the whole labour force, we had in May of this year 1.2 per cent unemployment, and we had .8 per cent unemployment according to the insurance measurement. So, there is a difference. I don't think when I speak of one per cent, 2 per cent or 4 per cent that there is a significant difference in the concepts of measuring from yours.

COMMISSIONER GIBSON: On the question of what is a tolerable price increase, do you believe that Swedish people will think prices will, in fact, rise one per cent or two per cent per annum in their anticipations of the future, or will they be impressed by what has actually happened over the last 15 years or so? To put the question another way, if there is an expectation that prices will rise one per cent or two per cent per annum, will it be possible to keep the rise to as little as that?

PROFESSOR LUNDBERG: This is, of course, a problem that is very important and has been discussed

PROFESSOR LUNDBERG: This is a very important aspect of thisproblem, of course, the measurement of unemployment is a very difficult problem, and a definition of what is "unemployment" is not easy. Previously we referred our unemployment rates to the rates of the insured workers, but nowadays we have also labour force investigations along the American methods. We do that twice a year, and have definitions very close to the American ones, and I presume it is almost the same as in Canada. According to the last labour force investigations relating to the whole labour force, we had in May of this year 1.2 per cent unemployment, and we had .8 per cent unemployment according to the insurance measurement. So, there is a difference. I don't think when I speak of one per cent, 2 per cent or 4 per cent that there is a significant difference in the concepts of measuring from yours.

COMMISSIONER GIBSON: On the question of what is a tolerable price increase, do you believe that Swedish people will think prices will, in fact, rise one per cent or two per cent per annum in their anticipations of the future, or will they be impressed by what has actually happened over the last 15 years or so? To put the question another way, if there is an expectation that prices will rise one per cent or two per cent per annum, will it be possible to keep the rise to as little as that?

PROFESSOR LUNDBERG: This is, of course, a problem that is very important and has been discussed

quite a lot, and many economists have tried to prove that if you have a rise in prices of 3 per cent or 4 per cent, and people expect it will continue, you will have an acceleration. But, that is not our experience. We in Sweden have had a 15-year period with an average of a 4 per cent rise per year, and nobody has anticipated that there will be a recovery of the value of money, but epxecting this decline to continue. There is, of course, no quantitative precision in the expectations but, anyhow, the whole likelihood is on the side of further price rises in the future. The Swedish monetary policy will never be able to prevent a price rise during booms and in the recessions the price rise will only be slower. Every intelligent person in Sweden has been anticipating a continuing inflation of that nature.

Responsible people in government and business, the leaders of trade unions, all those people who are quite aware of the facts reading economic literature to a higher extent than in most other countries and do not forget to speak and write about this. From this point of view it is an interesting fact, that although we have had these anticipations, the price rise has not accelerated; rather it has decelerated. We have come down from 4 per cent to 2 per cent although we are just now up again around 4 per cent. This is not, as I said, thanks so much to policy as to the international surroundings.

People in order to avoid losses from and make gains on inflation of course, buy fixed capital: they invest in houses, if they can, and in stocks to a certain

quite a lot, [illegible]

if you have a rise in prices of [illegible] per cent a year and people expect it will continue, you will have an acceleration. But, that is not our experience. We in Sweden have had a 15-year period with an average of a 4 per cent rise per year, and nobody has anticipated that there will be a recovery of the value of money, but expecting this decline to continue. There is, of course no quantitative precision in the expectations but, anyhow the whole likelihood is on the side of further price rises in the future. The Swedish monetary policy will never be able to prevent a price rise during booms and in the recessions the price rise will only be slower. Every intelligent person in Sweden has been anticipating a continuing inflation of that nature.

Responsible people in government and business, the leaders of trade unions, all those people who are quite aware of the facts reading economic literature to a higher extent than in most other countries and do not forget to speak and write about this. From this point of view it is an interesting fact, that although we have had these anticipations, the price rise has not accelerated; rather it has decelerated. We have come down from 4 per cent to 2 per cent although we are just now up again around 4 per cent. This is not, as I said, thanks so much to policy as to the international surroundings.

People in order to avoid losses from and make gains on inflation of course, buy fixed capital: they

[illegible]

extent, and are apt to borrow money and place the money in real capital. But, the flight to real values has not happened on such a scale that control has been lost. So, we have no experience of this danger of acceleration from this kind of anticipation.

COMMISSIONER GIBSON: Is there a long-term tendency in Sweden away from fixed interest obligations? Is there a decreasing interest in government securities and corporate bonds and a greater interest in equities and that sort of thing? In other words, do people show they expect prices to go on increasing in the future in their actions in the form of their savings?

PROFESSOR LUNDBERG: There is no quite clear evidence here, because if you take people's willingness to sign insurance policies, there has been no decline here.

COMMISSIONER GIBSON: That is true here also.

PROFESSOR LUNDBERG: However there is a clear tendency for people to take more risk insurance policies and less of the savings type. But, on the other hand, the funds of the insurance companies have been increasing very rapidly, as rapidly in real terms as before. Now there is a change, which we might discuss later on, referring to the pension funds coming in, but, except for that, we have not noticed any decline in this type of savings in insurance or in the form of savings deposits. People do have strong habits. On the other hand, there has been an increasing interest in buying homes and investing in equities and stocks. So that, the yields of stocks, especially shares in the wood industries, went down to around two per cent during the most inflationary

extent, and are apt to borrow money and place the money in real capital. But, the flight to real values has not happened on such a scale that control has been lost. So, we have no experience of this danger of acceleration from this kind of anticipation.

COMMISSIONER GIBSON: Is there a long-term tendency in Sweden away from fixed interest obligations? Is there a decreasing interest in government securities and corporate bonds and a greater interest in equities and that sort of thing? In other words, do people show they expect prices to go on increasing in the future in their actions in the form of their savings?

PROFESSOR LUNDBERG: There is no quite clear evidence here, because if you take people's willingness to sign insurance policies, there has been no decline here.

COMMISSIONER GIBSON: That is true here also.

PROFESSOR LUNDBERG: However there is a clear tendency for people to take more risk insurance policies and less of the savings type. But, on the other hand, the funds of the insurance companies have been increasing very rapidly, as rapidly in real terms as before. Now there is a change, which we might discuss later on, referring to the pension funds coming in, but, except for that, we have not noticed any decline in this type of savings in insurance or in the form of savings deposits. People do have strong habits. On the other hand, there has been an increasing interest in buying homes and investing in equities and stocks. So that, the yields of stocks, especially shares in the wood industries, went down to around two per cent during the most inflationary

time, because people consider that forests contain real values more than most other things with a guarantee for the value of money, but now the yields are back to 3 or 4 per cent again. But this holding of shares and stocks is much less spread in Sweden than in Canada and the United States. As to buying houses and real property, the values of houses available have been increasing sharply because of the excess demand for houses. There is a willingness of people to put themselves into debt and try to gain on real property. But, these tendencies have limited importance: the housing business part of the Swedish economy is very regulated, so the repercussion on the general economy has not been too serious.

There have thus been tendencies of this kind discussed, but we hope in regard to the 60's the prospects of inflation will be much less. People really don't expect that 4 per cent will continue as an average, and one per cent to two per cent we consider not bad from the point of view of carrying on a policy with other aims as given.

You have here on this continent consoling investigations as to the measuring of a rise in cost of living. One or two per cent increase in the cost of living might be no increase at all because of the improvement of the quality of the goods you present to the consumers. Of course, we never know, but what I would say is only that the prospects of inflation have really been pulled down quite a lot and we are happy with it. However, as already said we hardly dream of coming

time, because people consider that forests contain real values more than most other things with a guarantee for the value of money, but now the yields are back to 3 or 4 per cent again. But this holding of shares and stocks is much less spread in Sweden than in Canada and the United States. As to buying houses and real property, the values of houses available have been increasing sharply [illegible] There is a willingness of people to put themselves into debt and try to gain on real property. But, these tendencies have limited importance: the housing business part of the Swedish economy is very regulated, so the repercussion on the general economy has not been too serious.

There have thus been tendencies of this kind discussed, but we hope in regard to the 50's the prospect of inflation will be much less. People really don't expect that 4 per cent will continue as an average, and one per cent to two per cent we consider not bad from the point of view of carrying on a policy with other aims as given.

You have here on this continent convincing investigations as to the measuring of a rise in cost of living. One or two per cent increase in the cost of living might be no increase at all because of the improvement of the quality of the goods you present to the consumers. Of course, we never know, but what I would say is only that the prospects of inflation have really been pulled down quite a lot and we are happy with it. However, as already said we hardly dream of coming

down to zero rise of price level. We know that during the booms there will be a more rapid rise in prices, and during the recessions wages will never fall. There may be a downward pressure from abroad on import and export prices, but the general price level will not decline. This is our prospects and we take it with great calm.

COMMISSIONER LEMAN: I just wanted to ask Professor Lundberg if all countries can expect this pressure to come from abroad? In other words, if one country expects disciplines to be imported from abroad, the other country expects the discipline to come from abroad too, and that there will be no discipline anywhere?

PROFESSOR LUNDBERG: That is correct. Sweden is a small country with big neighbours, and as we have seen it there is, as you know, on the export markets usually heavier competition generally than on the more protected internal markets of the various countries. In the wood products, iron ore and steel products and so on, entrepreneurs are now aware that over-capacity and problems of selling are predominant problems. There will be boom periods when it will be easier to sell, but the need of keeping costs down and having to compete with efficient producers on the Continent and in America is the image our exporters have before them, and that also has an influence on other parts of the economy.

This kind of anticipation might be wrong. Most countries carry on an inflationary policy and the pressure downwards in prices may not materialize. But we think the type of development that we have in Sweden is rather general. We don't expect much of

down in this rise of price level. Because that during the booms there will be a more rapid rise in prices, and during the recessions wages will never fall. There may be a downward pressure from abroad on import and export prices, but the general price level will not decline. This is our prospects and we take it with great calm.

COMMISSIONER LEMAN: I just wanted to ask Professor Lundberg if all countries can expect this pressure to come from abroad? In other words, if one country expects disciplines to be imported from abroad, the other country expects the discipline to come from abroad too, and that there will be no discipline anywhere.

PROFESSOR LUNDBERG: That is correct. Sweden is a small country with big neighbours, and as we have seen it there is, as you know, on the export markets usually heavier competition generally than on the more protected internal markets of the various countries. In the wood products, iron ore and steel products and so on, entrepreneurs are now aware that over-capacity and problems of selling are predominant problems. There will be boom periods when it will be easier to sell but the need of keeping costs down and having to compete with efficient producers on the Continent and in America is the image our exporters have before them, and that also has an influence on other parts of the economy.

This kind of anticipation might be wrong. Most countries carry on an inflationary policy and the pressure downwards in prices may not materialize. But we think the type of development that we have in Sweden is rather general. We don't expect much of

general price increases on products coming from the United States and Canada. As to some continental countries, like Germany, the wage pressure has been higher than before, but production capacity has been increasing too rapidly. The surplus capacity that has developed means that these countries on our own Swedish market are selling and will be selling below their internal prices. They have often high protection and Sweden is a small market and we have low tariffs. Steel and other products come in to Sweden very cheaply, and as consumers we enjoy that. That is, however, a pressure that tells in quite clear language to the trade union leaders and entrepreneurs as well as to the government authorities about the dangers of too much wage inflation at home. I think people really consider this as fact.

COMMISSIONER BROWN: You mentioned that interest rates have increased so they are now about 5 per cent or 6 per cent. Have corporation profits been showing an increasing trend too to offset the increasing price levels?

PROFESSOR LUNDBERG: Yes. Profits have been increasing more or less parallel with the general sales volume of the entrepreneurs. Our profit measures are however not so good as yours or those of the United States, and as a statistician I am sorry for that. But as an entrepreneur I would be happy because the relatively free writing off system we use in Sweden is very good for corporations for concealing their profits. However, for making statistics it is

general price increases on products coming from the United States and Canada. As to some continental countries, like Germany, the wage pressure has been higher than before, but production capacity has been increasing too rapidly. The surplus capacity that has developed means that these countries on our own Swedish market are selling and will be selling below their internal prices. They have often high protection and Sweden is a small market and we have low tariffs. Steel and other products come in to Sweden very cheaply, and as consumers we enjoy that. That is, however, a pressure that tells in quite clear language to the trade union leaders and entrepreneurs as well as to the government authorities about the dangers of too much wage inflation at home. I think people really consider this as fact.

COMMISSIONER BROWN: You mentioned that interest rates have increased so they are now about 5 per cent or 6 per cent. Have corporation profits been showing an increasing trend too to offset the increasing price levels?

PROFESSOR LUNDBERG: Yes. Profits have been increasing more or less parallel with the general sales volume of the entrepreneurs. Our profit measures are however not so good as yours or those of the United States, and as a statistician I am sorry for that. But as an entrepreneur I would be happy because the relatively free writing off system we use in Sweden is very good for corporations for concealing their profits. However, for making statistics it is

a sad state of affairs. So, really we don't know too much about the actual profit development. If you look at gross profits in industrial companies, that is to say, profits including taxes and depreciations and all that, what you get when you deduct from sales all the current costs for raw material and wages, these gross profits have more or less kept a constant relationship over the last ten years to the production values. That means that productivity has been increasing and that industry has been shifting from less profitable to more profitable branches of activities over time. Now, there are discussions that this development will not hold in the future, as a consequence of the sharp competition on many markets that I spoke about before, the gross profit margins are tending to be reduced. That will mean that the corporations for their investments will not be self-financing to the extent they have been during the 50's.

This problem of profits should be mentioned also with regard to wage policies. The trade union economists make very skillful calculations about profitability in different branches of industry, and when profits tend to rise the unions are very eager and quick in demanding wage increases. So that, wages and profits follow each other quite well, just because of the watch kept by the wage earners on the development of profits.

COMMISSIONER BROWN: Are they prepared to go down as well as up?

a sad state of affairs. So, really we don't know too much about the actual profit development. If you look at gross profits in industrial companies, that is to say, profits including taxes and depreciations and all that, what you get when you deduct from sales all the current costs for raw material and wages, these gross [illegible] over the last ten years to the production values. That means that productivity has been increasing and that industry has been shifting from less profitable to more profitable branches of activities over time. Now, there are discussions that this development will not hold in the future, as a consequence of the sharp competition on many markets that I spoke about before, the gross profit margins are tending to be reduced. That will mean that the corporations for their investments will not be self-financing to the extent [illegible]

this problem of profits should be mentioned also with regard to wage policies. The trade union economists make very skillful calculations about profitability in different branches of industry, and when profits tend to rise the unions are very eager and quick in demanding wage increases. So that, wages and profits follow each other quite well, just because of the watch kept by the wage earners on the development of profits.

COMMISSIONER BROWN: Are they prepared to go down as well as up?

PROFESSOR LUNDBERG: No, never down, no.

COMMISSIONER GIBSON: If there are no other questions on the objectives of monetary and economic policy, I would like to ask Professor Lundberg a few questions about the nature of Swedish monetary policy.

In your recent writings, particularly in the Skandinaviska Banken Quarterly Review you have drawn a contrast between what you describe as the Swedish line of monetary policy and the American line. If I might quote you very briefly, you said, speaking of the Swedish line:

> "By means of one form, the policy may aim at creating -- through a system of liquidity and investment quotas, possibly including a ceiling on loans -- a number of obstacles to credit transfers and, in this way indirectly also holding back the rise in the velocity of circulation that would otherwise threaten to restrict or eliminate the dampening effect of a relative contraction in the supply of money. Controls, rationing and priorities for the controllable sectors of the credit market -- such measures belong to this type of policy which, for simplicity, we shall call the 'Swedish line'.
>
> The alternative form, which I call the 'American line', aims at avoiding public control of the credit market as an instrument of economic policy, instead allowing a

[illegible]: No, never down, no.

COMMISSIONER GIBSON: If there are no other questions on the objectives of monetary and economic policy, I would like to ask Professor Lundberg a few questions about the nature of Swedish monetary policy.

In your recent writings, particularly in the Skandinaviska Banken Quarterly Review you have drawn a contrast between what you describe as the Swedish line of monetary policy and the American line. If I might quote you very briefly, you said, speaking of the Swedish line:

> "By means of one form, the policy may aim at creating -- through a system of liquidity and investment quotas, possibly including a ceiling on loans -- a number of obstacles to credit transfers and, in this way indirectly also holding back the rise in the velocity of circulation that would otherwise threaten to restrict or eliminate the dampening effect of a relative contraction in the supply of money. Controls, rationing and priorities for the controllable sectors of the credit market -- such measures belong to this type of policy which, for simplicity, we shall call the 'Swedish line'.
>
> The alternative form, which I call the 'American line', aims at avoiding public control of the credit market as an instrument of economic policy, instead allowing a

contraction of the supply of money to have free play in the whole of the credit system via the functionings of the capital and credit markets.

The difference as compared with the Swedish line lies in the absence of attempts to utilize, as active weapons in the monetary policy armoury, measures that are designed to put the credit market partially out of function -- to make it operate especially badly during periods of inflationary expansion."

This is a very interesting statement, and I wonder in the light of that if you would care to tell us a little about the recent Swedish stabilization measures in the monetary sphere?

PROFESSOR LUNDBERG: I think we are a little on the way to trying to avoid too much of the type of rationing and credit ceiling policies and putting obstacles to the functioning of credit markets as we did during the boom up to 1957. There is a tendency to create a little more of a better functioning of capital and credit market -- not much, from an American point of view -- but I think there is a growing awareness among the authorities that in the long run it may be difficult to use this "Swedish" kind of interference policy.

[illegible] have free play in the whole of the credit system via the functionings of the capital and credit markets.

"[illegible] the Swedish line lies in the absence of attempts to utilize, as active weapons in the monetary policy armoury, measures that are designed to put the credit market partially out of function -- to make it operate especially badly during periods of inflationary expansion."

This is a very interesting statement, and I wonder in the light of that if you would care to tell us a little about the recent Swedish stabilization measures in the monetary sphere?

PROFESSOR LUNDBERG: I think we are a little on the way to trying to avoid too much of the type of rationing and credit ceiling policies and putting obstacles to the functioning of credit markets as we did during the boom up to 1957. There is a tendency to create a little more of a better functioning of capital and credit market -- not much, from an American point of view -- but I think there is a growing awareness among the authorities that in the long run it may be difficult to use this "Swedish" kind of interference policy.

On the other hand, the Swedish authorities have no great respect for the free functioning of the credit of capital markets as giving some kind of optional allocation of resources out of itself. You will find much more of that view in the United States. The functioning of the capital and credit markets, just as a market in our text books, is supposed to allocate the resources in such a way that you get some kind of an optimum distribution of the savings funds available to the economy.

In Sweden there are views as to priorities for using savings that the Swedish authorities think are not automatically taken care of by the market mechanisms. There are certain government expenditures of an investment nature that have high priority -- for building up the interest structure of the economy and they are, of course, allocated by fiscal means. That method is used in all countries. Secondly, and this is the most disturbing part of the policy, is our housing problem; this is perhaps the blackest part of Swedish economic policy. You know, the German people speak about "Wirtschaftswunder", which means the wonder that has happened in Germany with rapid economic development. We in Sweden have also a "Wirtschaftswunder", namely that we have had a record building of houses since the end of the war, we have had no destruction of houses because of the war and we have the lowest increase of rate population in the world, nearly, and yet we have one of the highest degrees of shortage of housing, of excess demand for

On the other hand, the Swedish authorities have no great respect for the free functioning of the credit of capital markets as giving some kind of optional allocation of resources out of itself. You will find much more of that view in the United States. The functioning of the capital and credit markets, just as a market in our text books, is supposed to allocate the resources in such a way that you get some kind of an optimum distribution of the savings funds available to the economy.

In Sweden there are views as to priorities for using savings that the Swedish authorities think are not automatically taken care of by the market mechanisms. There are certain government expenditures of an investment nature that have high priority -- for building up the interest structure of the economy and they are, of course, allocated by fiscal means. That method is used in all countries. Secondly, and this is the most disturbing part of the policy, is our housing problem; this is perhaps the blackest part of Swedish [illegible]. [illegible], the German people speak about "Wirtschaftswunder", which means the wonder that has happened in Germany with rapid economic development. We in Sweden have also a "Wirtschaftswunder", namely that we have had a record building of houses since the end of the war, we have had no destruction of houses because of the war and we have the lowest increase of rate population in the world, nearly, and yet we have one of the highest degrees of shortage of housing, of excess demand for

housing in most of the civilized world. This is a very disturbing factor to the policy measures because the government has to, or likes to, allocate a very large part of the gross savings for financing house building and therefore also must prevent a squeeze of the monetary policy from having bad effects on house building. In order to protect the financing of house building devices must be introduced and one such measure is liquidity quotas.

The banks have to keep, during monetary squeezes, a certain proportion of their assets in government bonds and in bonds financing house credits. (There are special institutions for that). The current credit for house building is also usually kept outside the policy measures. This means that a priority for house financing must be disturbing from the point of view of an "American" type of monetary policy preventing the free play of market forces on the credit markets. This is one of the backgrounds explaining the interference with the credit markets in Sweden.

COMMISSIONER GIBSON: You make a further point which is that under the American system, as you described, when money is tight and the demand for credit very strong, the rise in interest rates that occurs tends to increase the velocity of money or result in secondary credit creation, and this is very hard to control. You point out that the system of interfering with the transfers of credit, which you describe as typical of the Swedish line, does in fact slow down the velocity in the secondary

housing in most of the civilized world. This is a very [illegible] government has to, or likes to, allocate a very large part of the gross savings for financing house building and therefore also must prevent a squeeze of the monetary policy from having bad effects on house building. In order to protect the financing of house building devices must be introduced and one such measure is liquidity quotas.

The banks have to keep, during monetary squeezes, a certain proportion of their assets in government bonds and in bonds financing house credits. (There are special institutions for that). The current credit for house building is also usually kept outside the policy measures. This means that a priority for house financing must be disturbing from the point of view of an "American" type of monetary policy preventing the free play of market forces on the credit markets. This is one of the backgrounds explaining the interference with the credit markets in Sweden.

COMMISSIONER GIBSON: You make a further point which is that under the American system, as you described, when money is tight and the demand for credit very strong, the rise in interest rates that occurs tends to increase the velocity of money or result in secondary credit creation, and this is very hard to control. You point out that the system of interfering with the transfers of credit, which you describe as typical of the Swedish line, does in fact slow down the velocity in the secondary

creation of credit, and this is a fundamental point in your mind, I take it?

PROFESSOR LUNDBERG: Yes, that is the second point I am coming to now. The first point was the background for that kind of priority measures which were to secure the priority in getting savings for certain investment purposes. If you take government and housing expenditures and community expenditures, that is about half of the total gross investments in the economy. This position is excluded from the free play of the markets.

When we come to policies during a boom, to carry out a restrictive monetary policy, there are efforts in Sweden to work on, as you say, interfering with the credit system. In the past we have tried to put ceilings on bank advances, the total credit to industry and trade given by the commercial banks. This is one such type of interference of a very direct nature creating credit rationing.

Then, we have the type of liquidity ratios that I spoke about before. The Swedish concept is different from yours and from the American as also applying to the other banks or institutes at the side of the commercial banks.

There is a law concerning the putting into force of liquidity ratios that is potentially there. It had been used in 1950 - 1952, but potentially it can be put into force at any time when it is considered necessary. This law is more or less a basis for so-called "voluntary agreements" as private banks are

creation of credit, and this is a fundamental point in your mind, I take it?

PROFESSOR LUNDBERG: Yes, that is the second point I am coming to now. The first point was the background for that kind of priority measures which were to secure the priority in getting savings for certain investment purposes. If you take government and housing expenditures and community expenditures, that is about half of the total gross investments in the economy. This position is excluded from the free play of the markets.

When we come to policies during a boom, to carry out a restrictive monetary policy, there are efforts in Sweden to work on, as you say, interfering with the credit system. In the past we have tried to put ceilings on bank advances, the total credit to industry and trade given by the commercial banks. This is one such type of interference of a very direct [illegible]

Then, we have the type of liquidity ratios that I spoke about before. The Swedish concept is different from yours and from the American as also applying to the other banks or institutes at the side of the commercial banks.

There is a law concerning the putting into force of liquidity ratios that is potentially there. It had been used in 1950 - 1952, but potentially it can be put into force at any time when it is considered necessary. This law is more or less a basis for so-called "voluntary agreements" as private banks are

"quite willing" to make agreements rather than have the law put into force. The law might be more rigid and more dangerous to apply to the banks than having discussions and agreements on a freer basis with the central bank. The liquidity ratio given as a maximum, according to the new law, is 50 per cent, meaning that the commercial banks should keep in relation to the total deposits, government securities and treasury bills, as well as the housing corporation bonds up to this size. This means that if there is an increase in the prescribed liquidity ratio during a boom period there will be a squeeze on advances, loans to the private sector of the economy. There is also a law that gives possibilities of regulating, of putting maximum and minimum rates of interest on banks and the other savings institutions. During a squeeze of the banks when competing with each other, they may try to get more deposits from the public by raising rates of interest. The authorities can stop such tendencies by putting maximum on the rates of interest. Such a policy means that credit rationing will be the result. This law of regulating maximum and minimum rates of interest has never been applied. It gives also a background for making "voluntary agreements" with the banks of not competing with each other by raising interest rates too much.

THE CHAIRMAN: You wouldn't have arrived at this agreement unless the law were there?

[illegible] the law put into force. The law might be more rigid and more dangerous to apply to the banks than having discussions and agreements on a freer basis with the [illegible] maximum, according to the new law, is 50 per cent, meaning that the commercial banks should keep in [illegible] and treasury bills, as well as the mortgage corporation bonds up to this size. This means that if there is an increase in the prescribed liquidity ratio during a boom period there will be a squeeze on advances, loans to the private sector of the economy. There is also a law that gives possibilities of regulating, of putting maximum and minimum rates of interest on banks and the other savings institutions. During a squeeze of the banks when competing with each other, they may try to get more deposits from the public by raising rates of interest. The authorities can stop such tendencies by putting maximum on the rates of interest. Such a policy means that credit rationing will be the result. This law of regulating maximum and minimum rates of interest has never been applied. It gives also a background for making "voluntary agreements" with the banks of not competing with each other by raising interest rates too much.

THE CHAIRMAN: You wouldn't have arrived at this agreement unless the law were there?

PROFESSOR LUNDBERG: We don't know. I mean, they could always suspect such a law might be created anyhow, and Sweden is a small country and it is not too difficult to make an agreement with a handful of men about such policies. These people are reasonable even if the central bank is unreasonable in their demands on the commercial banks. All this means -- and that was my point in the article that you quoted, sir -- that the monetary policy in Sweden is to a very high extent relying on credit rationing policies by the institutions. The law for regulating rates of interest includes rules for controlling the issue of bonds and similar loan instruments. No industrial corporation can issue bonds without the allowance of the central bank with control of the conditions of issue.

All this means is that credit rationing will be an important instrument of policy in a monetary squeeze. Coming back to what you referred to as the velocity of circulation, such a squeeze will mean that corporations having deposits in the banks, when they don't get new advances or loans, and when their customers don't get it, that they will use these deposits at a higher speed than usually is the case. There is no possibility of preventing these grey markets -- we don't call them black because they are not very black. This increase of velocity of circulation of banking deposits is a factor counteracting monetary restriction. I think this effect is very important and quite good for the Swedish economy,

I mean, they could always suspect such a law might be created anyhow, and Sweden is a small country and it is not too difficult to make an agreement with a handful of men about such policies. These people are reasonable even if the central bank is unreasonable in their demands on the commercial banks. All this means -- and that was my point in the article that you quoted, sir -- that the monetary policy in Sweden is to a very high extent relying on credit rationing policies by the institutions. The law for regulating rates of interest includes rules for controlling the issue of bonds and similar loan instruments. No industrial corporation can issue bonds without the allowance of the central bank with control of the conditions of issue.

All this means is that credit rationing will be an important instrument of policy in a monetary squeeze. Coming back to what you referred to as the velocity of circulation, such a squeeze will mean that corporations having deposits in the banks, when they don't get new advances or loans, and when their customers don't get it, that they will use these deposits at a higher speed than usually is the case. There is no possibility of preventing these grey markets -- we don't call them black because they are not very black. This increase of velocity of circulation of banking deposits is a factor counteracting monetary restriction. I think this effect is very important and quite good for the Swedish economy.

because if you just stop the functioning of the credit market by putting sticks into the wheels, it will break down. Now, we have this secondary mechanism of using deposits and that means making the whole process smoother. Of course, there will be fluctuations and a dampening effect, as we have seen it, because the contracts between the different credit markets is not too close.

In our experience, especially referring to the smaller firms and smaller corporations, not having been able to accumulate large deposits, are coming into a squeeze especially severely. It is always the minority. That is always the difficulty with this world; in your common contacts with most people they will say that this kind of monetary policy does not work. They are not affected. I have met many industrial people from big corporations during our periods of monetary restrictions and they say they are not disturbed at all. And, of course, we mostly meet people who are not disturbed. We don't see so much of the minority who are disturbed because they are not frequent. According to the interviews carried out in Sweden -- and I refer to this in my memo -- it was just some quarter of the corporations, especially the smaller ones, which came into difficulties and had to cut down on investment programmes. That was quite sufficient to dampen the boom.

My point is that this is bad policy from many points of view. If we have a very rapid

because if you just stop the functioning of the credit market by withdrawing credit facilities, it will break down. Now, we have this secondary mechanism of using deposits and that means making the whole process smoother. Of course, there will be fluctuations and a dampening effect, as we have seen it, because the contacts between the different credit markets is not too close.

In our experience, especially referring to the smaller firms and smaller corporations, not having been able to accumulate large deposits, are coming into a squeeze especially severely. It is always the minority. That is always the difficulty with this world; in your common contacts with most people they will say that this kind of monetary policy does not work. They are not affected. I have met many industrial people from big corporations during our periods of monetary restrictions and they say they are not disturbed at all. And, of course, we mostly meet people who are not disturbed. We don't see so much of the minority who are disturbed because they are not frequent. According to the interviews carried out in Sweden -- and I refer to this in my memo -- it was just some quarter of the corporations, especially the smaller ones, which came into difficulties and had to cut down on investment programmes. That was quite sufficient to dampen the boom.

My point is that this is bad policy from many points of view. If we have a very rapid

repetition of booms and we have to use these interference instruments very frequently, it means in the longer run bad allocation of saving resources.

COMMISSIONER GIBSON: I was going to ask you about the allocation of resources and the question of equity in this kind of policy.

PROFESSOR LUNDBERG: I don't know if I have answered your question correctly, Mr. Gibson.

COMMISSIONER GIBSON: Well, what about the question of allocation of resources and the question of equity in this kind of a policy?

PROFESSOR LUNDBERG: You know, the Swedish government, as most governments, has no sense of scientific responsibility! They do too many things at the same time, so we can't find out the efficiency of the various policy instruments. We would like the government to have more sense of scientific isolation, of doing one thing at one time so that we could really find out how the policies work.

When we applied these stringent measures during the period up to 1957, and again in another form during the boom of 1960 and 1961, other measures were used very much too; we have had the investment tax and we have had the investment fund methods, and doing a lot of other things too, so we can't clearly read off the effect of each instrument.

[illegible]
instruments very frequently, it means in the longer run
bad allocation of saving resources.

COMMISSIONER GIBSON: I was going to ask you about the allocation of resources and the question of equity in this kind of policy.

PROFESSOR LUNDBERG: I don't know if I have answered your question correctly, Mr. Gibson.

COMMISSIONER GIBSON: [illegible] the question of allocation of resources and the question of equity in this kind of a policy

PROFESSOR LUNDBERG: You know, the Swedish government, as most governments, has no sense of scientific responsibility! They do too many things at the same time, so we can't find out the efficiency of the various policy instruments. We would like the government to have more sense of scientific isolation, of doing one thing at one time so that we could really find out how the policies work.

When we applied these stringent measures during the period up to 1957, and again in another form during the boom of 1960 and 1961, other measures were used very much too, we have had the investment tax and we have had the investment fund methods, and doing a lot of other things too, so we can't clearly read off the effect of each instrument.

COMMISSIONER GIBSON: You are, in fact, making a lot of deliberate decisions that involve the allocation of resources but not being too clear on what the end result is, I take it, is that fair?

PROFESSOR LUNDBERG: Yes, that is fair. You know, the primary aim is to dampen a boom that is developing. We notice a boom coming first usually in the investment field and the export field, and that can be seen a bit in advance. We make inquiries two or three times a year about investment plans, and even if the investment plans in industry and other fields are a little uncertain, they are indicating other tendencies of the development. When it is clear that an investment boom is developing, then the government tries to dampen it and when they dampen it, of course, they can't be sure that those investments which are eliminated or reduced are the least efficient, and less useful from a productivity point of view for the whole of the economy than those investments that are unaffected. Those corporations, whose investments are reduced have perhaps accidentally, too small deposits in the banks or haven't ultimate connections with the banks or haven't promises as to credit limits. But, who knows if these corporations have the least productive investment projects. Maybe the corporations in question have very efficient investment projects. But nobody can prove that, of course. I have made an

COMMISSIONER GIBSON: You are, in fact making a lot of deliberate decisions that involve the allocation of resources but not being too clear on what the end result is, I take it. Is that fair?

[illegible]

You know, the primary aim is to dampen a boom that is developing. We notice a boom coming first usually in the investment field and the export field, and that can be seen a bit in advance. We make inquiries two or three times a year about investment plans, and even if the investment plans in industry and other fields are a little uncertain, they are indicating other tendencies of the development. When it is clear that an investment boom is developing, then the government tries to dampen it and when they dampen it, of course, they can't be sure that those investments which are eliminated or reduced are the least efficient, and less useful from a productivity point of view for the whole of the economy than those investments that are unaffected. Those corporations, whose investments are reduced have perhaps accidentally, too small deposits in the banks or haven't ultimate connections with the banks or haven't promises as to credit limits. But, who knows if these corporations have the least productive investment projects. Maybe the corporations in question have very efficient investment projects. But nobody can prove that, of course. I have made an

investment study for a book published recently on the profitability of investment in the Swedish economy and tried by interviews of 200 corporations, to find out what were and are, during a certain time, the differences of the yield of various kinds of investments. That was during the time when credit squeezes were applied, and I was taken aback by the fact of how widely varying the yields were that there was a tremendous scale of difference between the projects, and to a certain extent I think this was the result of credit rationing policies.

If we had had a more fluid credit system, if the funds had been more flexible and could go to the investments -- that were most profitable -- we would get a better productivity result. I am afraid that there is danger of this sort in applying too much of credit rationing.

In every market where there is much of rationing, it can be expected in the long run to result in bad distribution of resources.

It is a strange thing that the Swedish economy, when talking about the labour market policy, then there is a very liberal attitude of making labour freely available and create an effectively functioning market. The trade union policy is aiming at reaching about the same price for the same kind of labour all over Sweden.

(page 4261 follows)

investment study for a book published recently on the profitability of investment in the Swedish economy and tried by interviews of 200 corporations, to find out what were and are, during a certain time, the differences of the yield of various kinds of investments. That was during the time when credit squeezes were applied, and I was taken aback by the fact of how widely varying the yields were that there was a tremendous scale of difference between the projects, and to a certain extent I think this was the result of credit rationing policies.

If we had had a more fluid credit system, if the funds had been more flexible and could go to the investments -- that were most profitable -- we would get a better productivity result. I am afraid that there is danger of this sort in applying too much of credit rationing.

In every market where there is much of rationing, it can be expected in the long run to result in bad distribution of resources.

It is a strange thing that the Swedish economy, when talking about the labour market policy, then there is a very liberal attitude of making labour freely available and create an effectively functioning market. The trade union policy is aiming at reaching about the same price for the same kind of labour all over Sweden.

(page 4261 follows)

The other way of having restrictive monetary policy and avoiding rationing would be to have a much higher rate of interest than we have had, as I mention in this memorandum. The investment tax that we used from 1955 to 1957 really means a "total rate of interest" of 12 to 18 per cent during those years. That tax was perhaps a better kind of means of allocating resources in a rational way than corresponding rationing of credit would have been.

Nobody can measure how much productivity will be lost by having a bad labour policy or a bad credit policy. I think we would have gained a little more if we had had a better monetary or credit policy. As I see it now, there is hope of doing it better during the 1960's than was the case during the 1950's, and that is partly because we are closer to equilibrium as between demand and supply than we were in the 1950's. That is another chapter which we might come back to.

THE CHAIRMAN: I think we should adjourn for a few moments at this time.

---A short recess.

COMMISSIONER LEMAN: Professor Lundberg, I want to ask you some questions about the effectiveness of monetary policy. Just before the recess I think you had begun to talk about that. You were explaining how you had made some inquiries in relation to this problem in trying to find out how people reacted, and what interest rates did to projects, etc. During the course of those inquiries did you go a little

The other way of having restrictive monetary policy and avoiding rationing would be to have a much higher rate of interest than we have had, as I mention in this memorandum. The investment tax that we used from 1955 to 1957 really means a "total rate of interest" of 12 to 18 per cent during those years. That tax was perhaps a better kind of means of allocating resources in a rational way than corresponding rationing of credit would have been.

Nobody can measure how much productivity will be lost by having a bad labour policy or a bad credit policy. I think we would have gained a little more if we had had a better monetary or credit policy. As I see it now, there is hope of doing it better during the 1960's than was the case during the 1950's, and that is partly because we are closer to equilibrium as between demand and supply than we were in the 1950's. That is another chapter which we might come back to.

THE CHAIRMAN: I think we should adjourn for a few moments at this time.

--- [illegible]

[illegible]

want to ask you some questions about the effectiveness of monetary policy. Just before the recess I think you had begun to talk about that. You were explaining how you had made some inquiries in relation to this problem in trying to find out how people reacted, and what interest rates did to projects, etc. During the course of those inquiries did you go a little

further and also try to get some quantitative measures of what we call the problem of lags in reaction, and the effectiveness of policy measures before they work through the system? That is a related subject. Would you tell us what you have discovered in this field?

PROFESSOR LUNDBERG: I think we are discussing two problems here, and also two inquiries or investigations. The one I referred to in my last speech was an interview study as to the kind of profitability rates, or rates of internal yield, that corporations demanded on the investment funds used during a certain period of time, and that had to do with a question of Mr. Gibson about the allocation of savings resources. What you are referring to now is the problem of the efficiency of monetary policy. What I spoke about was the inefficiency of monetary policy from the point of view that it created a disparity of yields that might have bad effects on the allocation of resources. You are referring now specifically to how effective the monetary policy is under certain circumstances in breaking a boom, and what lags we experienced.

Then I have referred to another inquiry mentioned in my memorandum that was done in 1955-56, and that one dealt with the effects on investment of the credit rationing and the investment tax, and the rise in interest rates during 1955 and 1956.

The results show that although we had a very rapidly development investment boom from the fall of 1954 the measures taken, beginning with the investment tax of 12 per cent and credit rationing with a ceiling on

further and also try to get some quantitative measures of what we call the problem of lags in reaction, and the effectiveness of policy measures before they work through the system? That is a related subject. Would you tell us what you have discovered in this field?

PROFESSOR LUNDBERG: I think we are discussing two problems here, and also two inquiries or investigations. The one I referred to in my last speech was an interview study as to the kind of profitability rates, or rates of internal yield, that corporations demanded on the investment funds used during a certain period of time, and that had to do with a question of Mr. Gibson about the allocation of savings resources. What you are referring to now is the problem of the efficiency of monetary policy. What I spoke about was the inefficiency of monetary policy from the point of view that it created a disparity of yields that might have had effects on the allocation of resources. You are referring now specifically to how effective the monetary policy is under certain circumstances in breaking a boom, and what lags we experienced.

Then I have referred to another inquiry mentioned in my memorandum that was done in 1955-56, and that one dealt with the effects on investment of the credit rationing and the investment tax, and the rise in interest rates during 1955 and 1956.

The results show that although we had a very rapidly development investment boom from the fall of 1954 the measures taken, beginning with the investment tax of 12 per cent and credit rationing with a ceiling on

advances applied to the commercial banks from the middle of 1955, and also an interest rate increase of one per cent, had the effect of dampening the investment plans of entrepreneurs and corporations within manufactures by about 15 per cent. According to these interview studies, investments became 15 per cent lower in 1955-56 than they had tended to be according to the interviews conducted in the fall of 1954 before these measures were taken.

Of course, interview studies are difficult and dangerous, and managers might like to just give personal views without giving much thought to the subject. But we have some confidence in those interviews conducted in 1955 and 1956 because they were made under relatively good auspices during a time when the managers were really re-considering their investment plans because of these very important changes in conditions that had happened during a short time, and the results fit relatively well into the statistics on investment that were available later on.

Accordingly, this resulted, as I have said, in a cutting down of investment by something like 15 per cent. That did not mean that investment actually went down by 15 per cent, but investments were lower than they would otherwise have been. That means that the measures taken in 1955 had a quick effect. There was not a long lag.

This lag business is a difficult problem, of course. In the United States especially there have been studies made of the lags in monetary

advances applied to the commercial banks from the middle of 1955, and also an interest rate increase of one per cent. had the effect of dampening the investment plans of entrepreneurs and corporations within manufactures by about 15 per cent. According to these interview studies, investments became 15 per cent lower in 1955-56 than they had tended to be according to the interviews conducted in the fall of 1954 before these measures were taken.

Of course, interview studies are difficult and dangerous, and managers might like to just give personal views without giving much thought to the subject. But we have some confidence in those interviews conducted in 1955 and 1956 because they were made under relatively good auspices during a time when the managers were really re-considering their investment plans because of these very important changes in conditions that had happened during a short time, and the results fit relatively well into the statistics on investment that were available later on.

Accordingly, this resulted, as I have said, in a cutting down of investment by something like 15 per cent. That did not mean that investment actually went down by 15 per cent, but investments were lower than they would otherwise have been. That means that the measures taken in 1955 had a quick effect. There was not a long lag.

This lag business is a difficult problem, of course. In the United States especially there have been studies made of the lags in monetary

and fiscal policy, and it has usually been found that there are usually quite long lags. Milton Friedman in Chicago is well known for his 16-month lag in monetary policy. However, I think that that kind of analysis is very dangerous because it is taken as a fact that there is something in the structure of the economy that makes entrepreneurs react to changes in economic conditions in a relatively fixed way. My view is, and that is to a certain extent confirmed by this Swedish interview study, that the lags in reaction depend very much upon how big the changes are. For instance, you can make such a drastic change as making all credit unavailable to those having ambitious investment plans so that most of those investments stop immediately. You can make the whole policy result in a catastrophe, and maybe have a lag of just a few seconds after the announcement.

Central banks are usually not too sure about economic projects so that they start by increasing the discount rate by a quarter of or half of one per cent. In such a case you might have no reaction at all during a long time, or you might even have an inverse reaction, because people might anticipate that this is just the beginning of a more restrictive monetary policy. They may think that a quarter of one per cent is clearly too little, and expect that after a time lag the central bank will discover that it is not enough and that the rate later will be raised more. The result tends to be that investment and borrowing are accelerated. In that case you may thus get an inverse or negative

and fiscal policy, and it has usually been found that there are usually quite long lags. Milton Friedman in Chicago is well known for his 15-month lag in monetary policy. However, I think that that kind of analysis is very dangerous because it is taken as a fact that there is something in the structure of the economy that makes entrepreneurs react to changes in economic conditions in a relatively fixed way. My view is, and that is to a certain extent confirmed by this Swedish interview study, that the lags in reaction depend very much upon how big the changes are. For instance, you can make such a drastic change as making all credit unavailable to those having ambitious investment plans so that most of those investments stop immediately. You can make the whole policy result in a catastrophe, and maybe have a lag of just a few seconds after the announcement.

Central banks are usually not too sure about economic projects so that they start by increasing the discount rate by a quarter of or half of one per cent. In such a case you might have no reaction at all during a long time, or you might even have an inverse reaction, because people might anticipate that this is just the beginning of a more restrictive monetary policy. They may think that a quarter of one per cent is clearly too little and expect that after a time lag the central bank will discover that it is not enough and then the rate later will be raised more. The result tends to be that investment and borrowing are accelerated. In that case you may thus get an inverse or negative-

lag when the policy creates the wrong kind of anticipation.

What was interesting from the point of view of the Swedish experience that I referred to, and what the interview studies show , is that if you make your policy changes drastic enough the anticipation will support the policy. High investment taxes and severe credit rationing cannot last long, so that people who could postpone investments did so rather than pay the investment tax of 12 per cent or get their financing on the grey markets at high cost and great risk. Those entrepreneurs, if at all possible, would rather wait before making investment or they would cut down on their investments in inventories. The latter happened to quite an extent. In order to finance fixed investments some entrepreneurs realized on inventories. When that happens you get good results because that means less pressure on the resources of the economy.

My point here is that the concept of lags should be referred to the size of the change in the monetary perimeters in question. My opinion is that if you make a drastic change in a boom such as developed in 1954 and 1955 you get efficient results. If the authorities in Sweden had made only some slight change in the discount rate and in the general monetary policy the boom might even have been stimulated during 1955.

I think this experience is interesting also from the point of view that you often hear of economists who do not believe in monetary policy

lag when the policy creates the wrong kind of [illegible]

What was interesting from the point of view of the Swedish experience that I referred to, and what the interview studies show , is that if you make your [illegible] support the policy. High investment taxes and severe credit rationing cannot last long, so that people who could postpone investments did so rather than pay the investment tax of 12 per cent or get their financing on the grey markets at high cost and great risk. Those entrepreneurs, if at all possible, would rather wait before making investment or they would cut down on their investments in inventories. The latter happened to quite an extent. In order to finance fixed investments some entrepreneurs realized on inventories. When that happens you get good results because that means less pressure on the resources of the economy.

My point here is that the concept of lags should be referred to the size of the change in the monetary perimeters in question. My opinion is that if you make a drastic change in a boom such as developed in 1954 and 1955 you get efficient results. If the authorities in Sweden had made only some slight change in the discount rate and in the general monetary policy the boom might even have been stimulated during 1955.

I think this experience is interesting also from the point of view that you often hear of economists who do not believe in monetary policy

saying that a needed drastic change in interest rates and in other policy measures in the monetary field will create a crisis; that they will create a collapse of investment. That did not happen in Sweden. There was a 12 per cent investment tax plus an increase in rates of interest so that the cost of money went up by 13 per cent over the year -- and that was drastic -- but the collapse did not occur. Investments stayed at a stable level.

If the Swedish authorities had done these measures in 1957 just at the top of the boom when international market conditions were deteriorating -- if we had been silly enough to introduce these measures after waiting so long -- then a catastrophe might well have occurred. There might under those conditions have happened a drastic cut-down in investment expenditure.

Timing is very important when studying lags and studying the effects. I do not know if I have answered your question. Perhaps I have answered only a part of it.

COMMISSIONER LEMAN: I would like to refer you to a statement you make at page 16 of your memorandum:

> "There has been relatively good success with policy measures aiming at counteracting recessionary tendencies. In a way, this has been an easier part of policy that the restriction problem during inflationary booms".

PROFESSOR LUNDBERG: Yes.

COMMISSIONER LEMAN: Why do you believe that

saying that a needed drastic change in interest rates and in other policy measures in the monetary field will [illegible] investment. That did not happen in Sweden. There was a 12 per cent investment tax plus an increase in rates of interest so that the cost of money went up by 15 per cent over the year -- and that was drastic -- but the collapse did not occur. Investments stayed at a stable level.

If the Swedish authorities had done these measures in 1957 just at the top of the boom when international market conditions were deteriorating -- if we had been silly enough to introduce these measures after waiting so long -- then a catastrophe might well have occurred. There might under those conditions have happened a drastic cut-down in investment [illegible]

[illegible] and studying the effects. I do not know if I have answered your question. Perhaps I have answered only a part of it.

COMMISSIONER LEMAN: I would like to refer you to a statement you make at page 16 of your memorandum:

"There has been relatively good success with policy measures aiming [illegible]

In a way, this has been an easier part of policy than the anti-inflation problem during inflationary booms."

PROFESSOR LUNDBERG: Yes.

COMMISSIONER LEMAN: Why do you believe that

was so?

PROFESSOR LUNDBERG: Well, that is an evaluation. You know, we succeeded in Sweden in the boom of 1955-57 in stopping the investment boom in industry. That is correct. That was a relative success. We did not succeed at all in preventing prices and wages from rising, and we did not succeed, generally, in preventing an excess demand for labour and for goods during that time. I mean that there was only a relative success. It could have been worse. We were more successful, perhaps, that some other countries, and it was important that we learn a little about the sensitivity of the economy to measures of this nature. But, on the other hands, I think that we were more clearly successful -- this is on the other side, of course -- in getting a counter-balancing effect during the recession of 1958-59.

I think that the most remarkable feature of the Swedish economic policy experience during the post-war period is that we succeeded in getting an investment boom during the recession. I do not know of any other country that has succeeded in that.

Of course, that was partly an effect of pulling down investment during the boom, so the periods should be looked upon combined. You are right in that. I could not just say that this success during the recession was independent of what had been done during the boom. The results are, of course, inter-dependent, but I think that when compared with other countries, and seeing the recessionary forces at work on the Swedish economy,

was so?

PROFESSOR LUNDBERG: Well, that is an evaluation. You know, we succeeded in Sweden in the boom of 1955-57 in stopping the investment boom in industry. That is correct. That was a relative success. We did not succeed at all in preventing prices and wages from rising, and we did not succeed, generally, in preventing an excess demand for labour and for goods during that time. I mean that there was only a relative success. It could have been worse. We were more successful, perhaps, that some other countries, and it was important that we learn a little about the sensitivity of the economy to measures of this nature. But, on the other hands, I think that we were more clearly successful -- this is on the other side, of course -- in getting a counter-balancing effect during the recession of 1958-59.

I think that the most remarkable feature of the Swedish economic policy experience during the post-war period is that we succeeded in getting an investment boom during the recession. I do not know of any other country that has succeeded in that.

Of course, that was partly an effect of pulling down investment during the boom, so the periods should be looked upon combined. You are right in that. I could not just say that this success during the recession was independent of what had been done during the boom. The results are, of course, inter-dependent, but I think that when compared with other countries, and see the recessionary forces at work on the Swedish economy,

Sweden was remarkably in getting an increase in industrial investment of 15 per cent from 1957 to 1958, and another increase of 15 per cent from 1958 to 1959, just by taking away restrictive measures that had been in force during the boom period of 1955-57, and also using the investment fund technique. That also played a role.

COMMISSIONER LEMAN: So that you contrast in your memorandum the measures that were taken in the 1955-57 boom with those that were taken in the 1959-61 boom, and the latter ones were of a different character and were much less pervasive in the sense that they implied less interference than was the case with respect to the first ones; am I correct in that?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER LEMAN: Is that due partly to the fact that you did not like some of the results of the measures taken in the 1955-57 boom, or is it because you then thought that the character of the 1959-61 boom was quite different from the first one?

PROFESSOR LUNDBERG: I think the second statement of yours is more correct. From the point of view of dampening the boom the measures during the 1955-57 period were relatively successful, but from the point of view of growth and productivity development of the economy in the longer run it was a dangerous policy.

This dampening down of investments in private industry during the boom meant, really, that the volume investments in 1957 were not higher than in the previous boom of 1951. We discussed that heavily in Sweden and I among others criticized the policy. From the growth point of view, in the longer run it was dangerous to keep down investment in private industry for such a long time by means which were effective for dampening a boom but dangerous from the growth point of view.

During the second boom, from 1959, government authorities were aware of the fact that it would be dangerous, again, to let private industry carry the burden. They were aware of the fact that changes in the world market were very impressive and that the Swedish industry had to adjust itself to the coming European market and other changes in the export markets; and we were afraid of getting behind in the rise of productivity in the other countries. It would be better with these perspectives to use the same type of measures and just to clamp down on investments in industry.

I think that speaks well for the authorites,

From the point

from the point of view of growth and productivity development of the economy in the longer run it was a dangerous policy.

This dampening down of investments in private industry during the boom meant, really, that the volume investments in 1957 were not higher than in the previous boom of 1951. We discussed that heavily in Sweden and I among others criticized the policy. From the growth point of view, in the longer run it was dangerous to keep down investment in private industry for such a long time by means which were effective for dampening a boom but dangerous from the growth point of view.

During the second boom, from 1959, government authorities were aware of the fact that it would be dangerous, again, to let private industry carry the burden. They were aware of the fact that changes in the world market were very impressive and that the Swedish industry had to adjust itself to the common European market and other changes in the export markets; and we were afraid of getting behind in the rise of productivity in the other countries. It would be better with these perspectives to use the same type of measures and just to clamp down on investments in industry.

that during the time 1959-61 they were more restrictive as to government expenditure and tried to restrict communal expenditure to a certain extent, so that restrictions on private investment in industry could be very limited. In a way one can only speak of the low effectiveness of monetary policy during this time, because the method of squeezing liquidity out of the commercial banks and putting on the stringent monetary policy, with rising interest rates and a certain amount of rationing, had hardly any visible effect we can now see on private investments during that time, and the boom was not interrupted up to 1961. I think that was a "successful failure" if that expression is allowed, and we are not quite clear as to what extent it was intended or was not intended. Anyhow, here you get a good example of what you were asking about in the first question, that there was a long lag between monetary stringencies and an effect on investments.

We are happy that investments in private industry were relatively undisturbed, and we developed in the traditional fields and the productivity increased in the Swedish economy generally. But here you have an example of a long lag of squeezing money out of the banks and, again, the effects on the industry. That was in contrast to the drastic measures taken in 1955.

This kind of policy was apparently intended, as people were aware that it would be dangerous to deter private investment of industry, of the type and

than during the time 1959-61 they were more restrictive as to government expenditure and [illegible] communal expenditure to a certain extent, so that restrictions on private investment in industry could be very limited. In a way one can only speak of the low effectiveness of monetary policy during this time, because the method of squeezing liquidity out of the commercial banks and putting on the stringent monetary policy, with rising interest rates and a certain amount of rationing, had hardly any visible effect we can now see on private investments during that time, and the boom was not interrupted up to 1961. I think that was a "successful failure" if that expression is allowed, and we are not quite clear as to what extent it was intended or was not intended. Anyhow, here you get a good example of what you were asking about in the first question, that there was a long lag between monetary stringencies and an effect on investments.

We are happy that investments in private industry were relatively undisturbed, and we developed in the traditional fields and the productivity increased in the Swedish economy generally. But here you have an example of a long lag of squeezing money out of the banks and, again, the effects on the economy. That was in contrast to the drastic measures taken in 1955.

This kind of policy was [illegible] as people were aware that it would be dangerous to deter private investment of industry, of the type and

to the degree that it had been done in 1955-57.

COMMISSIONER MACKINTOSH: In the earlier period the fault you later saw was that far too drastic a contraction was placed on the private sector while the public housing sector was protected from it; and the difference between the two was largely the difference in approach to those two sectors?

PROFESSOR LUNDBERG: Yes. There is the risk that the policy will be too effective. I think the experience in 1955-57 is very interesting, but it was disturbing in a sense. We dampened the boom, but it was on the cost of long-term productivity, and we could not risk to have that type of dampening again. There are always interactions between the short and long term, of course, in this respect. From the point of view of government expenditure the infrastructure of the economy had been increasing rapidly in relation to other fields during a long period. Then the government was more able to cut down and limit expenditures in those fields. That was one aspect of it. At the same time they were aware that because of development in the international field Swedish industry should not be too disturbed by a repetition of the measures taken in the 1955 to 1957 period.

Also, I should add -- and that is an important aspect that I forgot to mention before -- that the difference from the previous boom period was also that in the period 1960 to 1961 the government

[illegible]

[illegible] sector while the public housing sector was protected from it; and the difference between the two was largely the difference in approach to those two [illegible]

PROFESSOR LUNDBERG: Yes. There is the risk that the policy will be too effective. I think the experience in 1955-57 is very interesting, but it was disturbing in a sense. We dampened the boom, but it was on the cost of long-term productivity, and we could not risk to have that type of dampening again. There are always interactions between the short and long term, of course, in this respect. From the point of view of government expenditure the infra-structure of the economy had been increasing rapidly in relation to other fields during a long period. Then the government was more able to cut down and limit expenditures in those fields. That was one aspect of it. At the same time they were aware that because of development in the international field Swedish industry should not be too disturbed by a repetition of the measures taken in the 1955 to 1957 period.

Also, I should add -- and that is an important aspect that I forgot to mention before -- that the difference from the previous boom period was also that in the period 1960 to 1961 the government

aimed at dampening consumption expenditure by introducing an expenditure tax of a little over 4 per cent. That was, of course, a great difference from the previous period. The policy was to have the private investment sector more undisturbed and have more of the anti-inflationary policy directed towards private consumption and government expenditure.

COMMISSIONER MACKINTOSH: Did this result, to any degree, from a view that the later boom had a somewhat different pattern from the earlier boom; that consumption expenditures were a bigger factor in the later boom; or was it just that you wanted to spread the pressure over more of the economy?

PROFESSOR LUNDBERG: I think the second statement is correct, that we wanted to spread the pressure over more of the economy.

THE CHAIRMAN: During the 1957 to 1959 period when, you said, you got an investment boom during the recession, at that time was the demand for Swedish exports strong?

PROFESSOR LUNDBERG: It was weaker than it had been during the boom, but the export volume, I think, fell by one one per cent, or something like that, during 1958, and started recovering in the middle of 1959 very rapidly. In the long term view the export picture was very optimistic.

THE CHAIRMAN: That would have had quite an effect on improving the situation?

PROFESSOR LUNDBERG: Yes.

[illegible] per cent. That was, of course, a great [illegible] from the previous period. The policy was to have the private investment sector more undisturbed and have more of the anti-inflationary policy directed [illegible]

COMMISSIONER MacINTOSH. Did this result, to any degree, from a view that the later boom had [illegible] boom; that consumption expenditures were a bigger factor in the later boom; or was it just that you wanted to spread the pressure over more of the economy?

[illegible] statement is correct, that we wanted to spread the pressure over more of the economy.

THE CHAIRMAN: During the 1957 to 1959 period when, you said, you got an investment boom during the recession, at that time was the demand for Swedish exports strong?

PROFESSOR LUNDBERG: It was weaker than it had been during the boom, but the export volume, I think, fell by one per cent, or something like that, during 1958, and started recovering in the middle of 1959 very rapidly. In the long term view the export picture was very optimistic.

THE CHAIRMAN: That would have had quite an effect on improving the situation?

[illegible]

THE CHAIRMAN: I am wondering to what extent it was due to the monetary policy applied, or to what extent it was due to a steady demand which had the prospect of improving?

PROFESSOR LUNDBERG: I think it is both.

THE CHAIRMAN: I suppose it would be, yes.

PROFESSOR LUNDBERG: I presume the policy with regard to investment funds will be discussed later. But this part of policy of making entrepreneurs invest during a recession and having them postpone investment from a boom period to a recession period could only occur if they were optimistic about the future. Management have been expecting increased demand for export products, and in the home market in Sweden. They must be confident in future expansion prospects otherwise we would not get this type of reaction. The method is just to postpone the will to invest from the boom to the recession period and therefore counteract it. The recessional forces in Sweden have referred primarily to the exports and to inventories. In foreign countries there are heavy fluctuations in inventories of Swedish export products. When there is an inventory recession and not a general decline in demand you can preserve long term optimism. In fact, during the recession people were glad government policy had helped them to invest during a recessional time, when the availability of steel, cement and other products means that their investment

THE CHAIRMAN: [illegible]

extent it was due to the monetary policy applied, or to what extent it was due to a steady demand which had the prospect of improving?

PROFESSOR LUNDBERG: I think it is both.

THE CHAIRMAN: I suppose it would be,

PROFESSOR LUNDBERG: I presume the policy with regard to investment funds will be discussed later. But this part of policy of making entrepreneurs invest during a recession and having them postpone investment from a boom period to a recession period could only occur if they were optimistic about the future. Management have been expecting increased demand for export products, and in the home market in Sweden. They must be confident in future expansion prospects otherwise we would not get this type of reaction. The method is just to postpone the will to invest from the boom to the recession period and therefore counteract it. The recessional forces in Sweden have referred primarily to the exports and to inventories. In foreign countries there are heavy fluctuations in inventories of Swedish export products. When there is an inventory recession and not a general decline in demand you can preserve long term optimism. In fact, during the recession people were glad government policy had helped them to invest during a recessional time when the availability of steel, cement and other products means that their investment

costs were lower than if they had made their investment during the previous boom. This kind of help was, in a way, appreciated. But it depends very much on optimism in future development.

COMMISSIONER MACKINTOSH: This was a matter of taking out postponed investments in a situation in which you had a very strong growth trend.

PROFESSOR LUNDBERG: We have not had a very strong growth trend in Sweden, but a moderate growth trend. Of course, that depends on what you relate it to. There were expectations and confidence exhibited of expanding markets and full employment, and there was a drive on mechanization and cutting down costs; and that sort of investment was necessary because wages were rising rapidly.

COMMISSIONER MACKINTOSH: "Moderate" is a relative word. A moderate growth trend would look very strong to us in the last few years.

COMMISSIONER LEMAN: I am trying to understand a little more precisely why you lack confidence in the more traditional approach of squeezing through the bank system. Is it because you do not think you can have a significant enough rise in the cost of money, or because you find people get around the barriers you put up. Do people learn to get around the obstacles you put up? Is that partly the reason why you get more lags and lack of effectiveness?

PROFESSOR LUNDBERG: This, again, depends on

costs were lower than if they had made their investment during the previous boom. This kind of help was, in a way, appreciated. But it depends very much on optimism in future development.

COMMISSIONER MACKINTOSH: This was a matter of taking out postponed investments in a situation in which you had a very strong growth trend.

PROFESSOR LUNDBERG: We have not had a very strong growth trend in Sweden, but a moderate growth trend. Of course, that depends on what you relate it to. There were expectations and confidence exhibited of expanding markets and full employment, and there was a drive on mechanization and cutting down costs; and that sort of investment was necessary because wages were rising rapidly.

[illegible]

a relative word. A moderate growth trend would look very strong to us in the last few years.

COMMISSIONER LEMAN: I am trying to understand a little more precisely why you lack confidence in the more traditional approach of squeezing through the bank system. Is it because you do not think you can have a significant enough rise in the cost of money, or because you find people get around the barriers you put up. Do people learn to get around the obstacles you put up? Is that partly the reason why you get more leaks and lack of effectiveness?

PROFESSOR LUNDBERG: This, again, depends on

how drastic you are as to policy. When we had the credit rationing measures in 1955-56 we got, according to the interviews, half of the total effect of dampening down investment from this policy instrument. Investment tax took over the other half. So credit-rationing policies, with ceilings and liquidity arrangements, and all that, had an effect which was quite large during that period. That is an example of possible effectiveness when using the measures drastically. But in the 1960-61 period, when the measures taken were not so drastic, the time lags were long and the effects were hardly visible. We carried out no interviews to study the effect, but perhaps if you had interviewed at that time investment might have been still larger than actually came out. But we know too little about that period.

Also I should mention -- and I think I do say in my memo -- that conditions during the fifties were more difficult to manage by monetary policy means than we think they will be during the sixties, as we look at the sixties now. The inflationary anticipations were very strong in 1954 to 1957, when people were just geared toward the anticipation of rapid inflation and profit prospects were high and markets were booming. Then, people did not care so much for the cost of investment. It is very difficult to manage and prevent high booms by policy measures, and we have then to use quite drastic means. But as we look at the

how drastic you are as to policy. When we had the credit rationing measures in 1955-56 we got, according to the interviews, half of the total effect of dampening down investment from this policy instrument. Investment tax took over the other half. So credit-rationing policies, with ceilings and liquidity arrangements, and all that, had an effect which was quite large during that period. That is an example of possible effectiveness when using the measures drastically. But in the 1960-61 period, when the measures taken were not so drastic, the time lags were long and the effects were hardly visible. We carried out no interviews to study the effect, but perhaps if you had interviewed at that time investment might have been still larger than actually came out. But we know too little about that period.

Also I should mention -- and I think I do say in my memo -- that conditions during the fifties were more difficult to manage by monetary policy means than we think they will be during the sixties, as we look at the sixties now. The inflationary anticipations were very strong in 1954 to 1957, when people were just geared toward the anticipation of rapid inflation and profit prospects were high and markets were booming. Then, people did not care so much for the cost of investment. It is very difficult to manage and prevent high booms by policy measures, and we have then to use quite drastic means. But as we look at the

sixties with, as we discussed before, the expectations of inflation much lower, and with much less of security among management as to markets expanding with greater fear of excess capacity, with more international competition, and all that, and with less possibility of self-financing because of the profit squeeze and higher dependence on the banks and capital markets, then the economy will tend to be much more sensitive to policy changes than it has been before. We have no real experience of this, but that is our hunch. So we may not need to take so drastic measures as we did in the booms of the 1950's; but we have not had any experience that I can present to you about these prospects for the sixties. However, the atmosphere is quite different now, and the dependence of corporations on outside finance will be higher and, therefore, the sensitivity to monetary policy changes will probably be greater.

COMMISSIONER LEMAN: So, in effect, you did not mean to generalize about the lack of effectiveness; it depends on the circumstances?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER LEMAN: Again, talking about what happens when you use monetary policy measures of the known direct interference type, the more general type of credit squeeze, did you experience in Sweden some shifts in the way credit is obtained in the economy? In other words, have you had the type of thing that has developed

sixties with, as we discussed before, the expectations of inflation much lower, and with much less of security among management as to markets expanding with greater fear of excess capacity, with more international competition, and all that, and with less possibility of self-financing because of the profit squeeze and higher dependence on the banks and capital markets, then the economy will tend to be much more sensitive to policy changes than it has been before. We have no real experience of this, but that is our hunch. So we may not need to take so drastic measures as we did in the booms of the 1950's; but we have not had any experience that I can present to you about these prospects for the sixties. However, the atmosphere is quite different now, and the dependence of corporations on outside finance will be higher and, therefore, the sensitivity to monetary policy changes will probably be greater.

COMMISSIONER LEMAN: So, in effect, you did not mean to generalize about the lack of effectiveness; it depends on the circumstances?

[illegible]

[illegible] about what happens when you use monetary policy measures of the known direct interference type, the more general type of credit squeeze, did you experience in Sweden some shifts in the way credit is obtained in the economy? In other words, have you had the type of thing that has developed

here, this growth of what we call near banks? When you put the squeeze only on commercial banks do you find that gradually, if you give it time, people will develop other means of getting their credit?

PROFESSOR LUNDBERG: Yes, we have had that experience, but I do not think to the same extent that you have had. We have not that type of trust companies and instalment companies receiving deposits and being free from regulations that you have had here and in the United States. The big corporations having excess liquidity as deposits in the banks can also act as near banks, and they did so to quite an extent during 1955-57, and again now, during 1959-61. They will use their surplus deposits to help those people delivering goods to them, parts of equipment, and so on ---

COMMISSIONER GIBSON: Suppliers?

PROFESSOR LUNDBERG: Yes, suppliers. That will happen to quite an extent so that you will have a more effective use of surplus of liquidity in times like these. That is a smoothing kind of reaction to stringent policy. That is quite good, but it is also making policy measures much more effective.

We have also had experience, being a small country, that the import of capital from abroad has been interfering with the efficiency of the monetary restriction policies. Exporting companies have been able to get liquidity or

payments more quickly when they are in a squeeze than they otherwise would get. They have connections abroad and will be or will try to be paid more quickly than otherwise would be the case. In the same way, some import firms in other credit markets will get more credit for a longer period than otherwise would be the case. We can also see from the balance of payments, that our exchange reserves change more rapidly than ought to have been the case, according to the current items of balance of payments, indicating some kind of capital imports during times of credit stringency in Sweden. That had a limited effect, but that was a sign we have not complete autonomy, either, over monetary policy. So we have that kind of difficulty in Sweden, of making policy effective, because of the increasing velocity of deposits inside the country, and also some imports of credit from abroad.

COMMISSIONER MACKINTOSH: May I ask if you have a good deal of control over extensive capital movement?

PROFESSOR LUNDBERG: Yes, we have, but for the short term capital movement it can never be effective and it is not meant to be effective. The controls refer to the issuance of bonds and buying of Swedish shares. But as to the short term capital movement of credit on imports and exports there is no control of that nature.

COMMISSIONER LEMAN: In your memo you

[illegible]

[illegible]

abroad and will be or will try to be paid more quickly than otherwise would be the case. In the same way, some import firms in other credit markets will get more credit for a longer period than otherwise would be the case. We can also see from the balance of payments, that our exchange reserves change more rapidly than ought to have been the case, according to the current items of balance of payments, indicating some kind of capital imports during times of credit stringency in Sweden. That had a limited effect, but that was a sign we have not complete autonomy, either, over monetary policy. So we have that kind of difficulty in Sweden, of making policy effective, because of the increasing velocity of deposits inside the country, and also some imports of credit from abroad.

COMMISSIONER MACKINTOSH: May I ask if you have a good deal of control over excessive capital movement?

PROFESSOR LUNDBERG: Yes, we have, but for the short term capital movement it can never be effective and it is not meant to be effective. The controls refer to the issuance of bonds and buying of Swedish shares. But as to the short term apital movement of credit on imports and exports ere is no control of that nature.

COMMISSIONER LESMAN: In your memo you

explain that long term capital imports or exports have not played a significant role in the Swedish economy post-war. Is that just a fact, or part of a policy to discourage any such long term capital movements in or out of Sweden?

PROFESSOR LUNDBERG: I would say it is part of the policy. If we had had a real, big savings deficit and consequent need of capital from abroad, because of very ambitious investment plans, we would have, I think, seen to it that we have got capital imports from abroad.

explain that long term capital imports or exports have not played a significant role in the Swedish economy post-war. Is that just a fact, or part of a policy to discourage any such long term capital movements in or out of Sweden?

PROFESSOR LUNDBERG: I would say it is part of the policy. If we had had a real, big savings deficit and consequent need of capital from abroad, because of very ambitious investment plans, we would have, I think, seen to it that we have got capital imports from abroad.

Norway has done that to quite an extent. Norway receives capital imports from Sweden, and to a certain extent from other countries for investment in shipping, for instance. But, in Sweden we have not considered this as a need for the country.

Before 1913, before the First World War, Sweden was a heavy capital importer for construction of the railroads and housing and the building of the cities, but since then it has not been, and during the 20's we were net capital exporters. Since then there has been no real great discussion in Sweden about this. We feel, rather, we should be capital exporters to under-developed countries. In our last five-year plan, a certain part of our savings has been allocated to net capital exports, especially thinking of developments in under-developed countries. But, we have no plans of relying on capital imports.

COMMISSIONER LEMAN: You described earlier that according to your concept the growth factor in Sweden had been what you call quite moderate: do you think capital imports would tend to raise this rate somewhat, or not?

PROFESSOR LUNDBERG: I think it could, yes -- possibly, yes. We could develop certain sectors of our industries, especially if we have direct investments, as you have, for instance, from progressive German and French firms. I assume we could accelerate the growth in this way. But, we haven't considered that; we haven't thought it

Norway has done [illegible] receives capital imports from Sweden, and to a certain extent from other countries for investment in shipping, for instance. But, in Sweden we have not considered this as a need for the country.

[illegible] Sweden was a heavy capital importer for construction of the railroads and housing and the building of the cities, but since then it has not been, and during the 20's we were net capital exporters. Since then there has been no real great discussion in Sweden about this. We feel, rather, we should be capital exporters to under-developed countries. In our last five-year plan, a certain part of our savings has been allocated to net capital exports, especially thinking of developments in under-developed countries. But, we have no plans of relying on capital imports.

[illegible] that according to your concept the growth factor in Sweden had been what you call quite moderate: do you think capital imports would tend to raise this rate somewhat, or not?

[illegible] yes -- possibly, yes. We could develop certain sectors of our industries, especially if we have direct investments, as you have, for instance, from progressive German and French firms. I assume we could accelerate the growth in this way. But, we haven't considered that; we haven't thought it

necessary or that we needed that kind of impulse from abroad.

We have American branch plants and other countries to a limited extent in certain fields -- in the chemical industry and in oil -- but it plays a very minor role. We have not really found we are in a bad position as to difficulties of carrying out our growth policies in Sweden.

In Sweden, when we are discussing associating ourselves with the European Common Market, there has been a discussion about free capital movements and the goodness and the badness of having that, and Swedish opinion is very divided. You will find a lot of people afraid of having Swedish corporations governed by people in the Ruhr district, or wherever it may be. On the other hand, people have thought such capital imports and capital investment would be a good balancing factor against the socialist government; it would be less able to do things because there would be capital flight from Sweden.

What really happens is that the uncertainty if Sweden will be associated, and the uncertainty of whether the United Kingdom will be associated, is that a number of big Swedish corporations establish branch plants on the European continent, just as the Americans do, and that is also being discussed as a capital export that might mean some difficulty in regard to a full employment policy in Sweden.

necessary or that we needed that kind of impulse from abroad.

We have American branch plants and other countries to a limited extent in certain fields -- in the chemical industry and in oil -- but it plays a very minor role. We have not really found we are in a bad position as to difficulties of carrying out our growth policies in Sweden.

In Sweden, when we are discussing associating ourselves with the European Common Market, there has been a discussion about free capital movements and the goodness and the badness of having that, and Swedish opinion is very divided. You will find a lot of people afraid of having Swedish corporations governed by people in the Ruhr district, or wherever it may be. On the other hand, people have thought such capital imports and capital investment would be a good balancing factor against the socialist government; it would be less able to do things because there would be capital flight from Sweden.

What really happens is that the uncertainty if Sweden will be associated, and the uncertainty of whether the United Kingdom will be associated, is that a number of big Swedish corporations establish branch plants on the European continent, just as the Americans do, and that is also being discussed as a capital export that might mean some difficulty in regard to a full employment policy in Sweden.

We are more aware of the problems you raise now than we were before, but we have not taken, I think, officially any stand on these very big issues. We have not felt the need for net capital imports. According to the expression of Swedish opinion, you will find in the last five-year plan, that was published last fall, that there was an item of net capital exports as an expression of what we consider a reasonable attitude towards these problems.

COMMISSIONER LEMAN: But is it because you feel it would interfere with the effectiveness of control measures, or is it mostly an attitude of a more nationalistic character?

PROFESSOR LUNDBERG: The word "we" is very difficult in this connection. We are not any "we" in Sweden on our opinions of this very big issue. As I said, there are lots of people in private business who would like it, from the point of view, that it means the socialist government will be less dangerous than it otherwise would be. If we are more integrated with the European common market the government will have to have in Sweden a taxation policy that perhaps will be more in conformity with Mr. Erhardt's views, and that would provide for elbow-room for private business. On the other hand private business would dislike it at the same time when they think of Swedish corporations being bought out by Ruhr firms, and they do consider that a possibility. So, it is a

We are more aware of the problems you raise now than we were before, but we have not taken, I think, officially any stand on these very big issues. We have not felt the need for net capital imports. According to the expression of Swedish opinion, you will find in the last five-year plan, that was published last fall, that there was an item of net capital exports as an expression of what we consider a reasonable attitude towards these problems.

COMMISSIONER LEMAN: But is it because you feel it would interfere with the effectiveness of control measures, or is it mostly an attitude of a more nationalistic character?

PROFESSOR LUNDBERG: The word "we" is very difficult in this connection. We are not any "we" in Sweden on our opinions of this very big issue. As I said, there are lots of people in private business who would like it, from the point of view, that it means the socialist government will be less dangerous than it otherwise would be. If we are more integrated with the European common market the government will have to have in Sweden a taxation policy that perhaps will be more in conformity with Mr. Erhardt's views, and that would provide for elbow-room for private business. On the other hand private business would dislike it at the same time when they think of Swedish corporations being bought out by Ruhr firms, and they do consider that a possibility. So, it is a

schizophrenic attitude, and there is no settled view. Of course, in the long run we know we will be good Europeans, anyway, and we will be more or less integrated, but the transitional period will be difficult, and I think the reaction of the majority of the people is nationalistic: "Sweden is for Swedes". We have a policy set up of a nature that is very different from the policies in Italy, Germany and France, which we would like to preserve; that is, the majority opinion, and we do not like to be disturbed too much.

COMMISSIONER LEMAN: I can understand why there could be different opinions in the country etc., but the fact is that you do have a control of long-term capital movements.

PROFESSOR LUNDBERG: Yes.

COMMISSIONER LEMAN: What are the criteria used in administering this control? It must be a policy measure, and there must be criteria used in allowing certain capital movements?

PROFESSOR LUNDBERG: Yes, the criterion is that we need no capital imports and that Swedish shares should not be bought up by foreign holders. That is the attitude now. I was discussing more the prospects of a change in attitudes that might be one condition for entering the European communion. For my personal part,

and many Swedish people in the academic field would say the same, we would like to have more of the Viking attitude, entering the European scene as more or less full members and trying to change Europe according to our patterns. I think that would be a more positive view, and there are progressive forces in the United Kingdom and Germany and other countries that would make it very feasible, and I think that is a more positive point of view than trying to protect us from influences we consider bad just for the time being. Everything is in the flux of change, and the Europe of Adenauer and DeGaulle is not the Europe of 10 years ahead. We have to take part in big changes, and if we are members, together with other countries, we would have more possibility of shaping them according to our own ideals than if we were standing outside. However, the discussion is very vivid now in Sweden, and it will become more so.

COMMISSIONER LEMAN: This may be a slight deviation from the main subject of effectiveness, but you have a sentence near the bottom of page 6 which I will quote:

> "A conscious wage policy is also part of the scheme, aiming at economically justified wage relations."

You referred to that a little earlier. There has been a lot of discussion in North America about the adequacy of measurements of productivity, especially in discussions with labour groups etc. Do you feel that in Sweden you have arrived at satisfactory measurements

and many Swedish people in the academic field would say the same, we would like to have more of the Viking attitude, entering the European scene as more or less full members and trying to change Europe according to our patterns. I think that would be a more positive view, and there are progressive forces in the United Kingdom and Germany and other countries that would make it very feasible, and I think that is a more positive point of view than trying to protect us from influences we consider bad just for the time being. Everything is in the flux of change, and the Europe of Adenauer and DeGaulle is not the Europe of 10 years ahead. We have to take part in big changes, and if we are members, together with other countries, we [illegible] to our own ideals than if we were standing outside. However, the discussion is very vivid now in Sweden, and it will become more so.

COMMISSIONER LAMAN: This may be a slight deviation from the main subject of effectiveness, but you have a sentence near the bottom of page 6 which I will quote:

"A conscious wage policy is also part of the scheme, aiming at economically justified wage relations."

You referred to that a little earlier. There has been a lot of discussion in North America about the adequacy of measurements of productivity, especially in discussions with labour groups etc. Do you feel that [illegible]

of productivity in all important sectors?

PROFESSOR LUNDBERG: No, I am sorry we have not, and we can never have that; it is impossible. We have not shaped our Swedish industry in such a way that manufacturers produce goods that can be measured very well in quantity and quality. But we would not like to have a policy of shaping Swedish industry in order to get good measurements in statistics. That is too ambitions an aim and would not be accepted by the Swedish people.

When our big electric plants create generators of a tremendous size, the turbines, and so on, and quality and efficiency changes, and you have to weight this volume with other engineering products and compare that with the imput factors of labour and capital, you will never get a good measure of productivity. Our ways of measuring are not good and will never be. But, I think it is the same if you take a human eye or ear: what we hear and what we see is a very distorted and limited part of reality. That is a fact, isn't it? Statistical observations and techniques are just another way of observing reality that is very unsatisfactory from many points of view, just as the eye and ear. We have to use that means of observation and kind of communication when discussing economic development and productivity. We need these very inefficient instruments to get a picture of what is happening, and we use these instruments of communbcation and measuring progress and so on, and relative progress in

of productivity in all important sectors?

PROFESSOR LUNDBERG: No, I am sorry we have not, and we can never have that; it is impossible. We have not shaped our Swedish industry in such a way that manufacturers produce goods that can be measured very well in quantity and quality. But we would not like to have a policy of shaping Swedish industry in order to get good measurements in statistics. That is too ambitious an aim and would not be accepted by the Swedish people.

When our big electric plants create generators of a tremendous size, the turbines, and so on, and quality and efficiency changes, and you have to weight this volume with other engineering products and compare that with the input factors of labour and capital, you will never get a good measure of productivity. Our ways of measuring are not good and will never be. But, I think it is the same if you take a human eye or ear: what we hear and what we see is a very distorted and limited part of reality. That is a fact, isn't it? Statistical observations and techniques are just another way of observing reality that is very unsatisfactory from many points of view, just as the eye and ear. We have to use that means of conservation and kind of communication when discussing economic development and productivity. We need these very inefficient instruments to get a picture of what is happening, and we use these instruments of communication and measuring progress and so on, and relative progress in

in different branches of productivity. We try to improve on them, but the measures will never be good, but they are enough for carrying on sensible discussion between people.

COMMISSIONER LEMAN: I understood you earlier to mention the fact in certain industries productivity can be measured a little easier than in others, but in Sweden due to the pressure groups and high level of organization of labour there has been a tendency to equalize wages all over the country. In your brief you mention this means, for instance, that industries and firms with low productivity should not be subsidized by having relatively cheap labour. But, this equalization process, in effect, is a different form of subsidization, isn't it, on various sectors of the economy? If you artificially maintain wages in all sectors where the productivity does not justify it, you are subsidizing something, aren't you?

PROFESSOR LUNDBERG: No, that is not my view on this issue. It is an important problem and it is a philosphy that has been much discussed in Sweden. This problem has nothing to do directly with measurement of productivity. It is a kind of economic theory about how the economy operates. The simple thought behind it is that if firms and corporations in the different branches of activity of the economy operate and make their profitability calculations, and all that, on the basis of uniform costs of the factors of production over the whole economy, then there is a better chance of efficient allocation of our resources in the

in different branches of productivity. We try to improve on them, but the measures will never be good, but they are enough for carrying on sensible discussion between people.

COMMISSIONER LEMAN: I understood you earlier to mention the fact in certain industries productivity can be measured a little easier than in others, but in Sweden due to the pressure groups and high level of organization of labour there has been a tendency to equalize wages all over the country. In your brief you mention this means, for instance, that industries and firms with low productivity should not be subsidized by having relatively cheap labour. But, this equalization process, in effect, is a different form of subsidization, isn't it, on various sectors of the economy? If you artificially maintain wages in all sectors where the productivity does not justify it, you are subsidizing something, aren't you?

PROFESSOR LUNDBERG: No, that is not my view on this issue. It is an important problem and it is a philosophy that has been much discussed in Sweden. This problem has nothing to do directly with measurement of productivity. It is a kind of economic theory about how the economy operates. The simple thought behind it is that if firms and corporations in the different branches of activity of the economy operate and make their profitability calculations, and all that, on the basis of uniform costs of the factors of production over the whole economy, then there is a bette chance of efficient allocation of our resources in the

direction of getting maximum productivity result than if there is very unequal price of capital and labour in the different sectors of the economy.

If, for instance, to take an example, the engineering industry which in Sweden has the best wages and is very highly productive from this point of view, if investment people in this industry base their calculations on twice as high wages per hour as the marginal firms in the textile industry, then I think that allocation of labour between the industries would be less economic than if they had to pay the same price for the same quality of labour in the two branches of industry. If you have the wages for the same type of labour in the marginal textile firms in relation to wages in engineering then the textile firms will be able to operate on these wages and keep on labour with a very low productivity, with a very low added value. But the best engineering firms, paying twice the wages, have to have twice the productivity in order to keep labour on and use it in their application. If we, therefore, equalize wages so that the textile firms have to pay the same wages as the engineering firms, then a number of textile firms would say, "We can't pay these wages. It is too expensive. We will have no profits. We don't have that type of effective machinery, and so on", and they will have to dismiss workers. Under full employment conditions in the economy these workers will be taken over -- if it has the right kind of skills -- by the engineering firms. Then you will get an addition to

direction of getting maximum productivity result then if there is very unequal price of capital and labour in the different sectors of the economy.

If, for instance, to take an example, the engineering industry which in Sweden has the best wages and is very highly productive from this point of view, t investment people in this industry base their calculations on twice as high wages per hour as the marginal firms in the textile industry, then I think that allocation of labour between the industries would be less economic than if they had to pay the same price for the same quality of labour in the two branches of industry. If you have the wages for the same type of labour in the marginal textile firms in relation to wage in engineering then the textile firms will be able to operate on these wages and keep on labour with a very lo productivity, with a very low added value. But the best engineering firms, paying twice the wages, have to have twice the productivity in order to keep labour on and use it in their application. If we, therefore, equalize wages so that the textile firms have to pay the same wages as the engineering firms, then a number of textile firms would say, "We can't pay these wages. It is too expensive. We will have no profits. We don't have that type of effective machinery, and so on", and they will have to dismiss workers. Under full employme conditions in the economy these workers will be taken over -- if it has the right kind of skills -- by the engineering firms. Then you will get an addition to

the productivity of the economy as a whole. If the textile industry paid half the wages and had very small profits, and then these wage earners are transferred to the engineering firms paying twice as much, this transfer of labour will make an addition to the productivity of the country that will not be available and apparent when the manufacturers make their calculations if the wage differentials are high. If the wages are much lower in the textile industries, these industries will be subsidized at the cost of the high productivity engineering firms. It is from this type of philosophy on the effectiveness of the price and wage system that we get the basis of the calculations of productivity, and these profitability measurements would be able to show how best to allocate resources. Such calculations can help in mobilizing the labour force so as to shift it to the expanding trades.

COMMISSIONER GIBSON: Is there an incentive to move labour from one to another?

PROFESSOR LUNDBERG: Yes, that is an important issue. From the discussions on that issue during previous years -- and also in other countries -- you have to have a high wage differential in order to make workers move from the textile firms to the more productive engineering firms, and only if there is a high wage differential will there be reasons for workers to move. All studies show however that there is very little incentive for moving -- that people won't do it. American studies by a number of people have shown how little incentive there is for people to move from low wage industries to

the productivity of the economy as a whole. If the textile industry paid half the wages and had very small profits, and then these wage earners are transferred to the engineering firms paying twice as much, this transfer of labour will make an addition to the productivity of the country that will not be available and apparent when the manufacturers make their calculations if the wage differentials are high. If the wages are much lower in the textile industries, these industries will be subsidized at the cost of the high productivity engineering firms. It is from this type of philosophy on the effectiveness of the price and wage system that we get the basis of the calculations of productivity, and these profitability measurements would be able to show how best to allocate resources. Such calculations can help in mobilizing the labour force so as to shift it to the [illegible].

COMMISSIONER GIBSON: Is there an incentive to move labour from one to another?

PROFESSOR LUNDBERG: Yes, that is an important issue. From the discussions on that issue during previous years -- and also in other countries -- you have to have a high wage differential in order to make worker move from the textile firms to the more productive engineering firms, and only if there is a high wage differential will there be reasons for workers to move. All studies show however that there is very little incentive for moving -- that people won't do it. American studies by a number of people have shown how little incentive there is for people to move from low wage industries to

high wage industries as long as they have employment.

That is a weak argument for having wage differentials. If such incentives work rather badly and with low effectiveness, we consider the other aspect of the problem of having the same price for the same quality of labour all over the economy as being much more important, and then using other means of making people move. I mean, the best way of making people move is squeezing an industry, and that is a more rapid way if there are opportunities of being employed in other industries. According to our views and experience that is a much more effective set of instruments to make labour move and shift from low productivity to high productivity than a wage differential between occupations.

If we squeeze the textile industry in this example by pulling up the wages more in parity with engineering industries, and then if we have an active labour market policy, making it easy for those people having become unemployed to shift over to engineering industries and paying them for travelling over there and establishing themselves and getting a house, and all that, that will also -- and having labour exchange offices that keep all the information -- that will be a more effective instrument of creating that shift of labour source from low productivity to high productivity than having wage differentials.

We have certainly not reached that kind of perfect level of complete wage parity over the whole economy. There are lower wages in textile industries, and according to the statistics we have wage

high wage industries as long as they have employment.

That is a week argument for having wage differentials. If such incentives work rather badly and with low effectiveness, we consider the other aspect of the problem of having the same price for the same quality of labour all over the economy as being much more important, and then using other means of making people move. I mean, the best way of making people move is squeezing an industry, and that is a more rapid way if there are opportunities of being employed in other industries. According to our views and experience that is a much more effective set of instruments to make labour move and shift from low productivity to high productivity than a wage differential between occupations.

If we squeeze the textile industry in this example by pulling up the wages more in parity with engineering industries, and then if we have an active labour market policy, making it easy for those people having become unemployed to shift over to engineering industries and paying them for travelling over there and establishing themselves and getting a house, and all that, that will also -- and having labour exchange offices that keep all the information -- that will be a more effective instrument of creating that shift of labour source from low productivity to high productivity than having wage differentials.

We have certainly not reached that kind of perfect level of complete wage parity over the whole economy. There are lower wages in textile industries, and according to the statistics we have wage

differences between the lowest and the highest in the Swedish industry -- it is between 80 and 105 or 110 (100 = average) -- if we don't pay attention then to the difference of frequencies of various skills in the different parts of the industry. It is a rough measure that shows that we are relatively far away from parity employing exactly the same wage for the same skill in the different trades. But in relation to what I see in your statistics here, and in many other countries, this is much closer to parity than in most other countries. The trade unions in Sweden carry on a conscious policy of reaching this aim of parity.

However, as I said in the beginning of this hearing, the engineering industries for instance, are responding rapidly and are having new mechanical devices and are having rapidly increasing productivity and wage rates are always taking rapid upward slides, tending to go ahead with higher rates than in other branches of industry, so it is difficult to catch up. It is heavy work for the people in the older branches, the trade unions of the textiles and the leather industries, and so on, to really squeeze their own branches of industry, pointing at the rapid development of wages in the engineering and the wood industries and create unemployed people in their own branches of activity. It is a dynamic development but parity of wages is a static concept.

differences between the lowest and the highest in the Swedish industry -- it is between 80 and 105 or 110 (100 = average) -- if we don't pay attention then to the difference of frequencies of various skills in the different parts of the industry. It is a rough measure that shows that we are relatively far away from parity employing exactly the same wage for the same skill in the different trades. But in relation to what I see in your statistics here, and in many other countries, this is much closer to parity than in most other countries. The trade unions in Sweden carry on a conscious policy of reaching this aim of parity.

However, as I said in the beginning of this hearing, the engineering industries for instance, are responding rapidly and are having new mechanical devices and are having rapidly increasing productivity and wage rates are always taking rapid upward strides, tending to go ahead with higher rates than in other branches of industry, so it is difficult to catch up. It is heavy work for the people in the older branches, the trade unions of the textiles and the leather industries, and so on, to really squeeze their own branches of industry, pointing at the rapid development of wages in the engineering and the wood industries and create unemployed people in their own branches of activity. It is a dynamic development but parity of wages is a static concept.

COMMISSIONER BROWN: Would the same philosophy apply to the narrow margins you mentioned earlier existing between the skilled and unskilled labour?

PROFESSOR LUNDBERG: Yes. During the first port-war period there was a policy of trying to squeeze these differentials between skills. You know, the Swedes have a very strong feeling for "justice" of a special kind, and unevenness of distribution is one of the things that our socialist policy and our taxation policy is aiming at eliminating as far as possible. In the trade unions the unskilled people have a higher number than the skilled, so there was a cutting down of the differential for the skilled people with bad effects as to the supply of skilled people. But the laws of income formation are stronger than the conscious policies of the trade unions in their efforts. When entrepreneurs are willing to pay and the scarcity of people having the skills is very great and the wage slides are very high, the skilled differentials have been increasing. There has been some efforts at job evaluations, as in other countries, to find some kind of what people consider correct changes, but there is a tendency of accepting market-determined rather high skilled differentials now in Sweden. Not high enough according to some people's views, but higher than the ambitious were during the first post-war period.

COMMISSIONER BROWN: Would the same philosophy apply to the narrow margins you mentioned earlier existing between the skilled and unskilled labor?

PROFESSOR LUNDBERG: Yes. During the first post-war period there was a policy of trying to squeeze these differentials between skills. You know, the Swedes have a very strong feeling for "justice" of a special kind, and unevenness of distribution is one of the things that our socialist policy and our taxation policy is aiming at eliminating as far as possible. In the trade unions the unskilled people have a higher number than the skilled, so there was a cutting down of the differential for the skilled people with bad effects as to the supply of skilled people. But the laws of income formation are stronger than the conscious policies of the trade unions in their efforts. When entrepreneurs are willing to pay and the scarcity of people having the skills is very great and the wage slides are very high, the skilled differentials have been increasing. There has been some efforts at job evaluations, as in other countries, to find some kind of what people consider correct changes, but there is a tendency [illegible] differentials now in Sweden. Not high enough according to some people's views, but higher than the ambitious were during the first post-war period.

COMMISSIONER MACKINTOSH: Historically the skill differentials in Europe have been very much less than in America?

PROFESSOR LUNDBERG: That is right, and that is an expression of, I presume, partly conscious trade union policy trying to keep them down and partly also the higher relative skills in America.

COMMISSIONER MACKINTOSH: I think the original pattern came from the greater influx of unskilled labour as against skilled labour by immigration?

PROFESSOR LUNDBERG: That is possible, yes. In America, you mean?

COMMISSIONER MACKINTOSH: Yes.

PROFESSOR LUNDBERG: Yes, I can understand that. Of course, we would like to have less of differentials between skills than is the case, but I hope you people realize that it cannot be done by force, because skilled people contribute so much more to the productivity than unskilled. To stimulate people to acquire skills, is a better way of trying to keep down differentials, so that the supply of skilled people increases in relation to the demand. Increasingly much attention is paid to vocational training, getting young people into schools of training and by such means getting a greater supply of skilled people. Workers know that the woe of becoming unemployed is

[illegible]

the skill differentials in Europe have been very much less than in America?

[illegible]

and that is an expression of, I presume, partly conscious trade union policy trying to keep them down and partly also the higher relative skills in America.

COMMISSIONER MACKINTOSH: I think the original pattern came from the greater influx of unskilled labour as against skilled labour by immigration.

PROFESSOR LUNDBERG: That is possible, yes. In America, you mean?

COMMISSIONER MACKINTOSH: Yes.

[illegible] that. Of course, we would like to have less of differentials between skills than is the case, but I hope you people realize that it cannot be done by [illegible] much more to the productivity than unskilled. To stimulate people to acquire skills, is a better way of trying to keep down differentials, so that the supply of skilled people increases in relation to the demand. Increasingly much attention is paid to vocational training, getting young people into schools of training and by such means getting a greater supply of skilled people. Workers know that the woe of becoming unemployed is

much lower if they are skilled.

COMMISSIONER GIBSON: In regard to this policy of working towards wage equalization, are you not possibly making a decision that the industries that are declining are going on declining, and industries that are advancing are going to continue advancing; in other words, you are adding force to the existing trend and you are preventing the readjustment or recovery which sometimes occurs, is that a fair statement?

PROFESSOR LUNDBERG: I think that is very well expressed; I wish I could do as well as you do. That is really what we think is very necessary for having a rapid economic growth.

COMMISSIONER GIBSON: Suppose that you are wrong and suppose that these industries -- some of them -- do not go on growing rapidly?

PROFESSOR LUNDBERG: Yes, there are risks but, you know, we realize that we are very human and make mistakes, and the thing is only that we rely upon the visions of private entrepreneurs in the various branches of the industry. If the private firms have expansion plans and are introducing new techniques and demanding more of labour for the markets they aim at developing then the government authorities accept their good judgment. I think the socialist government is reasonable to do this and

much lower if they are skilled.

COMMISSIONER GIBSON: In regard to this policy of working towards wage equalization, are you not possibly making a decision that the [illegible] industries that are advancing are going to continue advancing; in other words, you are adding force to the existing trend and you are preventing the readjustment or recovery which sometimes occurs, is that a fair statement?

PROFESSOR LUNDBERG: I think that is very well expressed; I wish I could do as well as you do. That is really what we think is very necessary for having a rapid economic growth.

[illegible] you are wrong and suppose that these industries -- some of them -- do not go on growing rapidly?

PROFESSOR LUNDBERG: Yes, there are risks but, you know, we realize that we are very human and make mistakes, and the thing is only that we rely upon the visions of private entrepreneurs in the various branches of the industry. If the private firms have expansion plans and are introducing new techniques and demanding more of labour for the markets they aim at developing then the government authorities accept their good judgment. I think the socialist government is reasonable to do this and

and they don't think they have a better insight into what is the growth possibilities of industry than the entrepreneurs have.

The government has to accept the private investment plans and the expectations of the rapidly growing activity and only try to see to it that the entrepreneurs in growing sectors of the economy get the kind of resources -- especially of labour -- that they need for expansion and this without scrutinizing the plans. I think that will help the growth in Sweden very considerably. It is a great help to growth to increase the shift of resources by putting pressure on the declining branches and firms -- making their difficulties bigger by a rise of wages over the whole land.

COMMISSIONER GIBSON: It is a pretty tough policy for the weaker industries?

PROFESSOR LUNDBERG: Yesit is, but I can give you a concrete example.

After the Korean war in 1951 we had a recession, a slight recession in 1952, and this especially referred to the textile industry. That industry had been a growth industry during the first years after the war -- people needed clothing and the imports from other countries were at a low level. The textile industry therefore expanded their capacity very much during a tremendous boom. The textile firms drafted

And they don't think they have a better insight into what is the growth possibilities of industry

The government has to accept the private investment plans and the expectations of the rapidly growing activity and only try to see to it that the entrepreneurs in growing sectors of the economy get the kind of resources -- especially of labour -- that they need for expansion and this without scrutinizing the plans. I think that will help the growth in Sweden very considerably. It is a great help to growth to increase the shift of resources by putting pressure on the declining branches and firms -- making their difficulties bigger by a rise of wages over the whole land.

pretty tough policy for the weaker industries?

but I can give you a concrete example.

After the Korean war in 1951 we had a recession, a slight recession in 1952, and this especially referred to the textile industry. That industry had been a growth industry during the first years after the war -- people needed clothing and the imports from other countries were at a low level. The textile industry therefore expanded their capacity very much during a tremendous boom. The textile firms drifted

labour and the government did not interfere with that process. It was not a lasting expansion, and from 1952 on the industry came into a recession. When imports came in and import competition grew heavily prices fell and wages were rising,the textile firms were squeezed, and they demanded protection. This was a rational behavior from their point of view. Textile people said that imports were dumped from abroad at too low prices. The government didn't listen very well and the textile trade unions -- and this is a remarkable thing -- opposed protection against the entrepreneurs. The trade union judgment maintained that we don't like protection, we like to work in an efficient industry. I have used this example in Australia, to give effective contrast to the Australian pattern of behavior in a similar condition. When there are difficulties in the Australian industry coming into a special branch of activity then the trade union people, and the entrepreneurs in the same branch in an unholy alliance walk up to the Tariff Commission and get protection. The Australian industry tends to work along such lines. The Swedish trade union leader who objected to protection and said, "We like an efficient industry and not a protected one", is still a leader. The employment in the textile industry went down to about 40 per cent in five years time, and the

labour and the government did not interfere with that process. It was not a lasting expansion, and from 1952 on the industry came into a recession. When imports came in and import competition grew heavily prices fell and wages were rising, the textile firms were squeezed, and they demanded protection. This was a rational behavior from their point of view. Textile people said that imports were dumped from abroad at too low prices. The government didn't listen very well and the textile trade unions -- and this is a remarkable thing -- opposed protection against the entrepreneurs. The trade union judgment maintained that we don't like protection, we like to work in an efficient industry. I have used this example in Australia, to give effective contrast to the Australian pattern of behavior in a similar condition. When there are difficulties in the Australian industry coming into a special branch of activity then the trade union people, and the entrepreneurs in the same branch in an unholy alliance walk up to the Tariff Commission and get protection. The Australian industry tends to work along such lines. The Swedish trade union leader who objected to protection and said, "We like an efficient industry and not a protected one", is still a leader. The employment in the textile industry went down to about 40 per cent in five years time, and the

workers could stand that because of their confidence in the full employment policy. Of course there were difficulties for the people in the textile industry in getting employed, there were transfer difficulties. But as there was excess demand for labour especially in engineering and some other industries partly at the same places the unemployed were absorbed without much friction in new occupations. The engineering firms were happy to get hold of these people squeezed out from the textile industries.

There was also new localization of engineering plants with regard to availability of textile workers. The labour board can give valuable information as to where labour is available. In Sweden we have a system that an industry has to announce six months in advance before laying down a plant. If there is excess demand you will find the engineering plants will try to locate a new branch plant in a district where slack in employment exists or is expected. So, I think that this squeezing out of labour in the textile industry during certain periods has helped the general productivity. I think all this in a way is approaching a liberal dream of a society that is efficient and where you make resources quickly available to high productivity and growth industries. But you are quite right that the engineering industry in the long run might

[illegible] in the full employment policy. Of course there were difficulties for the people in the textile industry in getting employed, there were greater difficulties. But as there was excess demand for labour especially in engineering and some other industries partly at the same places the unemployed were absorbed without much friction in new occupations. The engineering firms were happy to get hold of these people squeezed out from the textile industries.

There was also new localization of engineering plants with regard to availability of textile workers. The labour board can give valuable information as to where labour is available. In Sweden we have a system that an industry has to announce six months in advance before laying down a plant. If there is excess demand you will find the engineering plants will try to locate a new branch plant in a district where slack in employment exists or is expected. So, I think that this squeezing out of labour in the textile industry during certain periods has helped the general productivity. I think all this in a way is approaching a liberal dream of a society that is efficient and where you make resources quickly available to high productivity and growth industries. But you are quite right that the engineering industry in the long run might

be making mistakes in the same way as the textile industry before. It might happen that the increased employment absorbed in the engineering industry is not a lasting project. The people expanding the plants are human and make mistakes. But we have to rely on them and the play of the free market. The people that work on the spot and look at the profitability prospects should be better aware of the tendencies of the market than the government authorities.

(Page 4299 follows)

be making mistakes in the same way as the textile industry before). It might happen that the increased employment absorbed in the engineering industry is not a lasting project. The people expanding the plants are human and make mistakes. But we have to rely on them and the play of the free market. The people that work on the spot and look at the profitability prospects should be better aware of the tendencies of the market than the government authorities.

(Page 4299 follows)

COMMISSIONER BROWN: In the 1960-61 boom, when you used monetary policies of a more general nature, was it your impression that it was availability of money that was the factor, or was it the increase in cost of money, or was it psychology? There was a lag in these reactions, as you have described, and they were not as effective as you had hoped at the time, but you were pleased they were not so effective. However, there must have been some effect. Which had the greater effect, or do you not have an opinion on this?

PROFESSOR LUNDBERG: We really do not know very much about it. We have made no special investigation as we did in the 1950's about the effects. We have only the figures that show that advances from the commercial banks were rapidly going up during 1961, and that investment in industry was increasing. We do not know how much more investment would have gone up if these measures were not taken. I am sorry, I am not able to answer your question with greater confidence. I am sure, with respect to marginal firms finding themselves in difficulties as to financing their investments, that they had to cut them down, especially investments in inventories, in order to finance themselves when they were being squeezed. I think that investments during these years were lower than they would otherwise have been. How much was the effect from liquidity ratios, and how much from an increase in the rate

when you used monetary policies of a more general nature, was it your impression that it was availability of money that was the factor, or was it the increase in cost of money, or was it psychology? There was a lag in these reactions, as you have described, and they were not as effective as you had hoped at the time, but you were pleased they were not so effective. However, there must have been some effect. Which had the greater effect, or do you not have an opinion on this?

PROFESSOR LUNDBERG: We really do not know very much about it. We have made no special investigation as we did in the 1950's about the effects. We have only the figures that show that advances from the commercial banks were rapidly going up during 1961, and that investment in industry was increasing. We do not know how much more investment would have gone up if these measures were not taken. I am sorry, I am not able to answer your question with greater confidence. I am sure, with respect to marginal firms finding themselves in difficulties as to financing their investments, that they had to cut them down, especially investments in inventories, in order to finance themselves when they were being squeezed. I think that investments during these years were lower than they would otherwise have been. How much was the effect from liquidity ratios, and how much from an increase in the rate

of interest is, of course, very difficult to say.

In the 1950's the rate of interest increased by one per cent and played a minor role, but that was only natural because the other measures were so drastic. However, in 1960 and 1961 I think an increase in the rate of interest of about the same size had considerably more effect. In power plant investment, for instance, the cost of capital plays a very important role. At that time also the market for electricity was more balanced than it had been during the 1950's. When you have a rise of rate of interest in a more balanced situation then you have a sizeable potential effectiveness on investment expenditure already at one per cent rise in the rate of interest -- with a time lag, of course. I think during the 1960's, when markets are more balanced, interest rates will have a more important effect than they had during the 1950's. But these are only hunches, and we have made no serious investigation into these possible effects.

COMMISSIONER BROWN: I have one further question on commercial banks that comes out of your remark about inventory financing. During this period when we had a fairly consistent increase in prices and when, therefore, firms have required more financing in order to carry the same inventory, has there been a permissive regular rate of interest in advances by the

commercial banks?

PROFESSOR LUNDBERG: By 'permissive" -- I do not understand that expression.

COMMISSIONER BROWN: In your controlling of the advances that are permitted by the commercial banks has the banks' cost of financing inventories been a factor in your permitting such increased advances?

PROFESSOR LUNDBERG: No, I do not think so. With the inventories and the price expectations you spoke of in the 1950's I think the increase in interest rates plays a minor role. It is really insignificant from this point of view. But, with respect to credit availability, if corporations have plans for investment projects and they consider them very important, and they continue these projects in spite of difficulties in financing them, then they will look to cutting down inventories and getting some money out of them in order to finance the fixed investments. That has helped to a certain extent. It is not the rate of interest, but it is the availability of finance that will affect the invesntory investment during such inflationary times. But, you are also talking about the policy of the commercial banks themselves?

COMMISSIONER BROWN: That is right, and the policy of the central bank in controlling the commercial banks?

PROFESSOR LUNDBERG: Yes. You cannot differentiate -- of course. The central bank can do very little or nothing with respect to how the advances that are renewed or that are still being used are distributed. The commercial banks do not know this themselves. When they give an increased advance to a corporation they do not have detailed figures as to how the money will be used. The bank has confidence in the corporations, and it is up to the corporations to use the money in the best way possible.

COMMISSIONER BROWN: I think you misunderstand my question. In looking at the increase in credit that is permitted by the commercial banks is the factor of the increase in price level taken into consideration by the authorities?

PROFESSOR LUNDBERG: By the authorities? No, it is not. When they put a ceiling on advances for instance the central bank does not like to consider that prices will increase. The central bank would like to stop that increase, and, therefore, in real terms the ceiling would mean that the volume of advances outstanding would decline. So, from that point of view the authorities do not accept the fact of increased needs for advances just to cover the consequences of increases in prices. That would be almost the same as having them express an acceptance of inflation.

COMMISSIONER BROWN: But they do accept it,

in fact, do they not?

PROFESSOR LUNDBERG: That is quite another thing from saying: "Now, we would like to restrict bank advances, but we know that prices will increase so we will give you just enough to cover the rise in price". That would be the beginning of the end of a central banker if he expressed himself in that way. Of course, the commercial banks will complain, pointing out that what the policy is doing when a credit ceiling is set is that as prices and wages increase there will be a greater squeeze on them than intended. They would say that, and of course the central bank authorities would retort: "Are we as good as that? We are happy to hear that you are complaining because if you should not be complaining then we would be going a bad job". The Riksbank would thus never use expected price and wage increases as a factor in allowing a credit increase. They know that that will happen, of course, but they will not take it into consideration in advance. When prices have increased and they take a new position after a year then they have to take into consideration that the price rises have occurred, and so shift their position.

COMMISSIONER BROWN: So they do it <u>post facto</u> rather than ---

PROFESSOR LUNDBERG: Yes, but not explicitly. You will never find it out in their statements, or anything like that. It is the same with respect to entrepreneurs pleading for more advances and more credit from the commercial banks. They will point

in fact, do they not?

PROFESSOR LUNDBERG: That is quite another thing from saying: "Now, we would like to restrict bank advances, but we know that prices will increase so we will give you just enough to cover the rise in price". That would be the beginning of the end of a central banker if he expressed himself in that way. Of course, the commercial banks will complain, pointing out that what the policy is doing when a credit ceiling is set is that as prices and wages increase there will be a greater squeeze on them than intended. They would say that, and of course the central bank authorities would retort: "Are we as good as that? We are happy to hear that you are complaining because if you should not be complaining then we would be going a bad job". The Riksbank would thus never use expected price and wage increases as a factor in allowing a credit increase. They know that that will happen, of course, but they will not take it into consideration in advance. When prices have increased and they take a new position after a year then they have to take into consideration that the price rises have occurred, and so shift their position.

COMMISSIONER BROWN: So they do it post facto rather than ---

PROFESSOR LUNDBERG: Yes, but not explicitly. You will never find it out in their statements, or anything like that. It is the same with respect to entrepreneurs pleading for more advances and move credit from the commercial banks. They will point

to the fact of higher values of inventories they have, and the waiting costs of the fixed plants they are erecting. They will say that investments are more expensive than they were last year and that therefore they need more advances of credit and higher limits than they had last year. That attitude is natural and necessary. The commercial banks will understand the reasons, and if they have the cash they will accept the claims, but if they have not the cash then they will not accept them and will put on the squeeze. You know, much of the policy of restricting a boom will be in terms of not accepting the fact of the rise in prices. The fighting of a boom is the fighting of a too rapid increase in prices. But the fight usually is not very effective. We agree on that.

COMMISSIONER GIBSON: Has the government given any direction or advice to the banks, when the banks have had to engage in these lending processes, as to the kind of industries that ought to get the credit.

PROFESSOR LUNDBERG: Yes they have done that in a very general form. I think it is the same type of form as in most other countries. When the Riksbank explains or makes statements to urge commercial banks and other institutions to hold back credit advances it then expresses a general view against speculative credits, instalment credits, and so on. The banks are told they should be especially careful in those directions, and are told to favour credits for expanding export capacity for

to the fact of higher values of inventories they have, and the waiting costs of the fixed plants they are erecting. They will say that investments are more expensive than they were last year and that therefore they need more advances of credit and higher limits than they had last year. That attitude is natural and necessary. The commercial banks will understand the reasons, and if they have the cash they will accept the claims, but if they have not the cash then they will not accept them and will put on the squeeze. You know, much of the policy of restricting a boom will be in terms of not accepting the fact of the rise in prices. The fighting of a boom is the fighting of a too rapid increase in prices. But the fight usually is not very effective. We agree on that.

COMMISSIONER GIBSON: Has the government given any direction or advice to the banks, when the banks have had to engage in these lending processes, as to the kind of industries that ought to get the credit.

PROFESSOR LUNDBERG: Yes they have done that in a very general form. I think it is the same type of form as in most other countries. When the Riksbank explains or makes statements to urge commercial banks and other institutions to hold back credit advances it then expresses a general view against [illegible] and so on. The banks are told they should be especially careful in those directions, and are told to favour credits for expanding export capacity for

instance. You will find such statements especially during the early post-war years.

COMMISSIONER GIBSON: Do they get the same view from the trade unions that an expanding industry ought to get more consideration than a weak industry?

PROFESSOR LUNDBERG: No. They know the commercial banks watch for that themselves, but you do raise an interesting point. These are just loose statements in a general way, and are statements which have not much effect on the carrying out of policy, but there have been interesting discussions in Sweden along the lines that you have just suggested.

COMMISSIONER BROWN: I was merely asking; not suggesting.

PROFESSOR LUNDBERG: Yes. The trade union people have been complaining that the commercial banks especially are protecting the weak industries in Sweden. They say that the banks like to throw good money after bad money in order to help weak and unproductive firms in order not to lose money. They say that if the banks were more rude, and tried to see to it that there was more of failures and bankruptcies in the Swedish economy, by not granting credit to enterprises and firms that have not very good chances of getting along, then savings could be transferred to the more productive industries and growth would occur more quickly. Union economists have been attacking the commercial banks for not being "capitalistic" enough -- for not trying to

instance. You will find such statements especially during the early post-war years.

COMMISSIONER GIBSON: Do they get the same view from the trade unions that an expanding industry ought to get more consideration than a weak industry?

PROFESSOR LUNDBERG: No. They must the commercial banks watch for that themselves, but you do raise an interesting point. These are just loose statements in a general way, and are statements which have not much effect on the carrying out of policy, but there have been interesting discussions in Sweden along the lines that you have just suggested.

COMMISSIONER BROWN: I was merely asking; not suggesting.

PROFESSOR LUNDBERG: Yes. The trade union people have been complaining that the commercial banks especially are protecting the weak industries in Sweden. They say that the banks like to throw good money after bad money in order to help weak and unproductive firms in order not to lose money. They say that if the banks were more rude, and tried to see to it that there was more of failures and bankruptcies in the Swedish economy, by not granting credit to enterprises and firms that have not very good chances of getting along, then savings could be transferred to the more productive industries and growth could occur more quickly. Trade unionists have been attacking the commercial banks for not being "capitalistic" enough -- for not trying to

maximize their profits by withdrawing money from the bad firms and putting it in other directions.

The banks answer: "How do you know? We think that this is a good industry or firm in the long run and it will get over the difficulties if we help them. We will take a chance. What will be the results if a corporation which is a customer to a bank finds out that when they are in financial difficulties the bank backs out immediately? They would not like to use such a bank, and that would mean a lower rate of progress." There is the fact that in Sweden the trade union people, have great confidence in the government seeing to it that there is full employment, and not much unemployment and accept a shuffling of labour from one firm to another. So they are not too much concerned if a bank carries on a rude sort of policy and brings the "bad" firms into bankruptcy.

This is an interesting problem because there might be cases where the commercial banks really are too slow and too kind to firms or branches of activity. So, I think this kind of discussion is useful and should go on. It is an interesting kind of duscussion, and I think the banks are right in answering that it is not as easy as it seems. If a bank thinks a firm is badly managed it may make it a condition for the renewal of the credit that another man shall manage the firm. Things like that are done from the point of view of efficiency.

Perhaps the Swedish authorities are rather

maximise their profits by withdrawing money from the bad firms and putting it in other directions.

The banks answer: "How do you know? We think that this is a good industry or firm in the long run and it will get over the difficulties if we help them. We will take a chance. What will be the results if a corporation which is a customer to a bank finds out that when they are in financial difficulties the bank backs out immediately? They would not like to use such a bank, and that would mean a lower rate of progress." There is the fact that in Sweden the trade union people, have great confidence in the government seeing to it that there is full employment, and not much unemployment and accept a shuffling of labour from one firm to another. So they are not too much concerned if a bank carries on a rude sort of policy and brings the "bad" firms into bankruptcy.

This is an interesting problem because there might be cases where the commercial banks really are too slow and too kind to firms or branches of activity. So, I think this kind of discussion is useful and should go on. It is an interesting kind of discussion, and I think the banks are right in answering that it is not as easy as it seems. If a bank thinks a firm is badly managed it may make it a condition for the renewal of the credit that another man shall manage the firm. Things like that are done from the point of view of efficiency.

unique in these aspects. When one looks at the American scene one gathers from their trade union people that all they are interested in is security of employment in such forms as a shorter working week. The workers like to stay where they are, and they do not so easily find opportunities for work in other places. The attitude in two such countries as U.S.A. and Sweden are quite different in these respects.

COMMISSIONER GIBSON: This is a very interesting argument, and not one we have heard very much of here.

PROFESSOR LUNDBERG: I think it is a useful discussion that is going on. My students, for instance, often come to this problem. They see it discussed in the papers. They often discuss the belief that the commercial banks are protecting the bad branches of activity and therefore braking the rise in the productivity of Swedish industry. I think the commercial banks are right in answering these problems in the ways they do, but I also think it is good for them to be irritated a little towards higher efficiency in the use of capital.

On the other hand, we would like to see that the government does something towards making the credit market function with greater effectiveness. In Sweden we should not only look at labour and its efficiency, and increase its mobility with regard to the more effective firms. We should also look at credit and savings being distributed in a proper

unique in these aspects. When one looks at the American scene one gathers from their trade union people that all they are interested in is security of employment in such forms as a shorter working week. The workers like to stay where they are, and they do not so easily find opportunities for work in other places. The attitude in two such countries as U.S.A. and Sweden are quite different in these views.

COMMISSIONER GIBSON: This is a very interesting argument, and not one we have heard very much of here.

PROFESSOR LUNDBERG: I think it is a useful discussion that is going on. My students, for instance, often come to this problem. They see it discussed in the papers. They often discuss the belief that the commercial banks are protecting the bad branches of activity and therefore braking the rise in the productivity of Swedish industry. I think the commercial banks are right in answering these problems in the ways they do, but I also think it is good for them to be irritated a little towards higher efficiency in the use of capital.

On the other hand, we would like to see that the government does something towards making the credit market function with greater effectiveness. In Sweden we should not only look at labour and its efficiency, and increase its mobility with regard to the more effective firms. We should also look at credit and savings being distributed in a proper

fashion, and having an effectively functioning credit market with high mobility. That is an important part of economic policy. The answer to that is partly: take away our credit restrictions. Take away the elements of direct control because they are hampering free play on the Swedish capital market.

THE CHAIRMAN: We shall now adjourn until 2:15 p.m.

---Luncheon adjournment.

[illegible]

hampering free play on the Swedish capital market.

THE CHAIRMAN: We shall now adjourn until 2:15 p.m.

---Luncheon adjournment---

--- On resuming at 2.20 p.m.

THE CHAIRMAN: We shall now resume. Professor Lundberg, I think we would be very much interested if you would give us some information about the constitution and powers and activities of the central bank in Sweden. I understand it is quite different in some respects from the other central banks. I may be wrong in that.

PROFESSOR LUNDBERG: Well, I think that constitutionally it is rather different. Ours is the oldest central bank in the world. It came into being as a central bank in 1668; and it became, from the beginning, a bank constitutionally directly under the control of parliament. Six of the members of the board of the bank are appointed by parliament, and only one by the government. The constitution of the bank was drawn observing the fact that governments are apt to misuse central bank power, for financing wars and other escapades by printing money, and the way of government is thus to use the central bank for that purpose. Therefore, there was a reaction against the government having the means of financing its own extravagances by means of the central bank, They wanted to guard against this by putting the central bank under parliamentary power and, constitutionally, it is still the case.

As I said, six of the seven members of the board are appointed by parliament, and the

THE CHAIRMAN: We shall now resume. Professor Lundberg, I think we would be very much interested if you would give us some information about the constitution and powers and activities of the central bank in Sweden. I understand it is quite different in some respects from the other central banks. I may be wrong in that.

PROFESSOR LUNDBERG: Well, I think that constitutionally it is rather different. Ours is the oldest central bank in the world. It came into being as a central bank in 1668: and it became, from the beginning, a bank constitutionally directly under the control of parliament. Six of the members of the board of the bank are appointed by parliament, and only one by the government. The constitution of the bank was drawn [illegible] to misuse central bank power, for financing wars and other escapades by printing money, and the way of government is thus to use the central bank for that purpose. Therefore, there was a reaction against the government having the means of financing its own extravagances by means of the central bank. They wanted to guard against this by putting [illegible] constitutionally, it is still the case.

As I said, six of the seven members of the board are appointed by parliament, and the

seventh by the government. However, in reality, especially under the conditions we have had during the last 35 years -- or how many years is it since 1932? -- 30 years, with a socialist majority, or a close socialist majority, the government has also had control of the majority of the board. That means that the board has been quite close to the government in its general outlook. I can imagine, with this constitutional set-up of the Riksbank, that with a minority government, with a government coming into power after the socialists, there might be some disparity between the government and the central bank. We have however some experience that this formal independence of the central bank can mean something to the policy carried out. The last time it happened was in the summer of 1957 when, during the boom and the pressure on the economy, the board of the Riksbank increased the rate of interest by one per cent, without consultation with the government. Of course, they were constitutionally within their rights in doing that. The government was mostly on vacation, and the board took the opportunity of doing this; but the result was that the chairman of the board, who is appointed by the government, was dismissed. The Governor of the Riksbank is however still the same man. That was a small incident of the independence of the central bank. Generally it has been the rule that the Riksbank consults with the government regarding major policy changes.

[illegible] by the government. However, in reality, especially under the conditions we have had during the last 35 years -- or how many years is it since 1932? -- 30 years, with a socialist majority, or a close socialist majority, the government has also had control of the majority of the board. That means that the board has been quite close to the government in its general outlook. I can imagine, with this constitutional set-up of the Riksbank, that with a minority government, with a government coming into power after the socialists, there might be some disparity between the government and the central bank. We have however some experience that this formal independence of the central bank can mean something [illegible]. The last time it happened was in the summer of 1957 when, during the boom and the pressure on the economy, the board of the Riksbank increased the rate of interest by one per cent, without consultation with the government. Of course, they were constitutionally within their rights in doing that. The government was mostly on vacation, and the board took the opportunity of doing this; but the result was that the chairman of the board, who is appointed by the government, was dismissed. The Governor of the Riksbank is however still the same man. That was a small incident of the independence of the central bank. Generally it has been the rule that the Riksbank consults with the government regarding major policy changes.

So, the constitution is one thing. The actual working is that the policy of the central bank, of the Riksbank, is closely co-ordinated with the government and therefore with fiscal policy. There is very close cooperation between the finance department and the Riksbank.

There was discussion in Sweden, during the early post-war years as well as during the inter-war years, to the effect that the Riksbank, the central bank, should be responsible for the value of money to a higher extent than the government usually is, and that the Riksbank should pay special attention to this policy aim. The government's expansionary policy should be circumscribed and checked by the Riksbank, guarding the value of money by carrying out a stringent policy when the government is too expansive. It was thought that some government expansionist policies had to be guarded against by the Riksbank, and that the constitution should be made effective in practice by allowing the Riksbank to "fight" government policy.

That was a theoretical thought going back in the history of doctrines, and had not much practical application, except for the episode in the summer of 1957.

As I have already said, there is rather complete co-ordination of central bank and other government policies. The central bank has its

current duties, but when there are bigger issues and problems involved they are always in close consultation with the government, and especially with the finance minister. This close alliance between fiscal and Riksbank policy was confirmed during the last years of the war, and during the post-war years, when Mr. Dag Hammarskjold, the late Secretary-General of the United Nations, was secretary of the finance department and at the same time chairman of the Riksbank Board. That was a sign of the close co-ordination that started during that time. Not having that kind of personal unification, it is still the same kind of policy that is carried out.

THE CHAIRMAN: As to the membership of the board, from what group of people does the government choose members of the board?

PROFESSOR LUNDBERG: The parliament chooses.

THE CHAIRMAN: The parliament?

PROFESSOR LUNDBERG: Yes, and they choose them from among politicians.

THE CHAIRMAN: Do you mean their own members of parliament?

PROFESSOR LUNDBERG: Not necessarily, not always -- no. I have even been a candidate myself -- not very willingly, as a candidate of one of the parties which would have liked to have me in, though I have never been a member of parliament.

duties, but when there are bigger issues and problems involved they are always in close consultation with the government, and especially [illegible] between fiscal and Riksbank policy was confirmed during the last years of the war, and during the post-war years, when Mr. Dag Hammarskjold, the late [illegible] secretary of the finance department and at the same time chairman of the Riksbank board. That was a sign of the close co-ordination that started during that time. Not having that kind of personal unification, it is still the same kind of policy that is carried out.

THE CHAIRMAN: As to the membership of the board, from what group of people does the government choose members of the board?

PROFESSOR LUNDBERG: The parliament chooses.

THE CHAIRMAN: The parliament?

PROFESSOR LUNDBERG: Yes, and they choose them from among politicians.

THE CHAIRMAN: Do you mean their own members of parliament?

PROFESSOR LUNDBERG: Not necessarily, not always -- no. I have even been a candidate myself -- not very willingly, as a candidate of one of the parties which would have liked to have me in, though I have never been a member of parliament.

It is the political parties, according to the weight they have in parliament, that see to it that their people are represented on the board.

Of course, you know how politics works. It is a kind of remuneration for fine old men who may not understand much of monetary policy but are put into positions on this board -- and I am sure they learn a lot. Therefore, the Riksbank has a strong hand. They can put the issues, and the response from this board is very much along the lines of the government having the power and seeing to it that the major decisions are made along the lines of the general government economic policy. I am sure you will understand they are not presumed to be experts at all; it is just a case of laymen sitting in.

THE CHAIRMAN: It is somewhat similar to the board that has been described to us of the Bank of England, which is a board of people who have different vocations and represent different business activities -- trade unions and other activities of that kind. But I do not think they would contemplate appointing a politician in England.

PROFESSOR LUNDBERG: But they do that here.

THE CHAIRMAN: You have greater trust in them, perhaps, than is exhibited elsewhere.

It is the political parties, according to the weight they have in parliament, that see to it that their people are represented on the board.

Of course, you know how politics works. It is a kind of remuneration for fine old men who may not understand much of monetary policy but are put into positions on this board -- and I am sure [illegible]

has a strong hand. They can put the issues, and the response from this board is very much along the lines of the government having the power and seeing to it that the major decisions are made along the lines of the general government economic policy. I am sure you will understand they are not presumed to be experts at all; it is just a case of laymen sitting in.

THE CHAIRMAN: It is somewhat similar to the board that has been described to us of the Bank of England, which is a board of people who have different vocations and represent different business activities -- trade unions and other activities of that kind. But I do not think they would contemplate appointing a politician in England.

PROFESSOR LUNDBERG: But they do that here.

THE CHAIRMAN: You have greater trust in them, perhaps, than is exhibited elsewhere.

PROFESSOR LUNDBERG: I do not think so.

COMMISSIONER LEMAN: Professor Lundberg, is there a statute which defines what duties the bank has to perform?

PROFESSOR LUNDBERG: There is a bank act, yes, but as to the general aims and management of policy it is so generally worded that you cannot read much out of it.

COMMISSIONER LEMAN: It is not precise?

PROFESSOR LUNDBERG: No, it is not precise at all.

COMMISSIONER LEMAN: It does not define these objectives we were talking about this morning?

PROFESSOR LUNDBEG: No, it is worded with a view to seeing to it that monetary development and currency supply is according to the needs of the country, and things like that, giving a completely free interpretation for those managing policy.

COMMISSIONER LEMAN: Does it use words like, "the protection of the value of the currency" -- and such?

PROFESSOR LUNDBERG: No, not in the Bank Act, but it is taken up in the bank committee of the parliament, where they stress and put down the aims and policies of the Riksbank.

THE CHAIRMAN: What are the qualifications of the governor?

PROFESSOR LUNDBERG: I do not think so.

COMMISSIONER LEMAN: Professor Lundberg, is there a statute which defines what duties the bank has to perform?

PROFESSOR LUNDBERG: There is a bank act, yes, but as to the general aims and management of policy it is so generally worded that you cannot read much out of it.

COMMISSIONER LEMAN: It is not precise?

PROFESSOR LUNDBERG: No, it is not precise at all.

COMMISSIONER LEMAN: It does not define these objectives we were talking about this morning?

PROFESSOR LUNDBERG: No, it is worded with a view to seeing to it that monetary development and currency supply is according to the needs of the country, and things like that, giving a completely free interpretation for [illegible] policy.

COMMISSIONER LEMAN: Does it use words like, "the protection of the value of the currency" -- and such?

PROFESSOR LUNDBERG: No, not in the Bank Act, but it is taken up in the bank committee of the parliament, where they stress and put down the aims and policies of the Riksbank.

THE CHAIRMAN: What are the qualifications of the governor?

PROFESSOR LUNDBERG: Excuse me, I did not understand.

THE CHAIRMAN: What are the qualifications of the governor? In choosing a governor is there a fairly wide choice? Do they ever choose a man who is not an expert to be governor of the bank?

PROFESSOR LUNDBERG: Yes, it is a completely wide-open choice. In the early days they usually chose a man having had much experience in banking, and appointed a man like Zvar Rooth, who then became head of the Monetary fund. He had been director or vice-chancellor of a private commercial bank before that. After him they took an economist -- I do not know if you consider that as on an expert level -- and, again, after that they took a man from the civil service who had had much to do with the finance department. The present governor came from the trade union side, and was originally a forest worker, having gone a long way in educating himself, becoming a journalist, and after that coming into government work, in a department that had nothing to do with money and monetary policy. He was suddenly appointed the governor of the Riksbank, having had hardly anything to do with these problems. He was a general civil servant at that time having acquired a good general economic background knowledge and administrative experience, but not an expert in central bank matters.

THE CHAIRMAN: You do not always have

not understand.

The CHAIRMAN: What [illegible]

of the governor? In choosing a governor is there a fairly wide choice? Do they ever choose a man who is not an expert to be governor of the bank?

PROFESSOR LUNDBERG: Yes, it is a completely wide-open choice. In the early days they usually chose a man having had much experience in banking, and appointed a man like Ivar Rooth, who then became head of the Monetary Fund. He had been director or vice-chancellor of a private commercial bank before that. After him they took an economist -- I do not know if you consider that as on an expert level -- and, again, after that they took a man from the civil service who had had much to do with the finance department. The present governor came from the trade union side, and was originally a forest worker, having gone a long way in educating himself, becoming a journalist, and after that coming into government work, in a department that had nothing to do with money and monetary policy. He was suddenly appointed the governor of the Riksbank, having had hardly anything to do with these problems. He was a general civil servant at that time having acquired a good general economic background knowledge and administrative experience, but not an expert in central bank matters.

THE CHAIRMAN: You do not always have

an expert?

PROFESSOR LUNDBERG: No. Having had this institution since 1668 you cannot avoid that.

There are a number of people in the Riksbank who are steadily employed there, of course. Then you have a board of directors who will know about these things, and there is a close contact with the commercial banks. But the government is completely free in nominating the kind of man they think is reliable and good from their point of view.

COMMISSIONER BROWN: What is the term of appointment? Is it for the life of the existing parliament, or for a fixed period of years?

PROFESSOR LUNDBERG: I am not quite certain, but I think it is a rather short appointment -- something like five or seven years -- but I do not remember exactly how long it is. But there are of course re-appointments.

COMMISSIONER BROWN: You mentioned the possibility of a difference of opinion if there was a change in majority in parliament and a change in government. How would such a difficulty be resolved?

PROFESSOR LUNDBERG: The board members are only appointed for a limited time period, and if parliament changes occur and there are new groupings, they will fall out and there will be a new board.

COMMISSIONER BROWN: So if there was any difference of opinion this would be very short-lived.

PROFESSOR LUNDBERG: Yes.

an expert?

[illegible] this institution since 1668 you cannot avoid that. There are a number of people in the Riksbank who are steadily employed there, of course. Then you have a board of directors who will know about these things, and there is a close contact with the commercial banks. But the government is completely free in nominating the kind of man they think is reliable and good from their point of view.

COMMISSIONER BROWN: What is the term of appointment? Is it for the life of the existing parliament, or for a fixed period of years?

PROFESSOR LUNDBERG: I am not quite certain, but I think it is a rather short appointment -- something like five or seven years -- but I do not remember exactly how long it is. But there are of course re-[illegible]

COMMISSIONER BROWN: You mentioned the possibility of a difference of opinion if there was a change in majority in parliament and a change in government. How would such a difficulty be resolved?

PROFESSOR LUNDBERG: The board members are only appointed for a limited time period, and if parliament changes occur and there are new groupings, they will fall out and there will be a new board.

[illegible] difference of opinion this would be very short-[illegible]

PROFESSOR LUNDBERG: Yes.

COMMISSIONER GIBSON: It is just a little group around the governor who are the people who really make monetary policy? You described the governor as being somebody outside, as a rule?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER GIBSON: But who actually formulates monetary policy from week to week and month to month? Is there an executive committee around him?

PROFESSOR LUNDBERG: Yes. There is an executive committee, with a chairman, the governor being the chairman; and there is a vice-governor, and there is a deputy from the board also. They are working together and meet each day and formulate and carry out the current policy, and the whole board meets once a week.

A discount rate change can only happen at a certain weekday, because that decision has to be taken by the board, after consultation with the government. But there is an expert executive committee, as you would call it, taking a stand and managing the current policy.

COMMISSIONER GIBSON: Is there a group of officials within the organization who constantly discuss the matters and submit recommendations to the governor and board?

PROFESSOR LUNDBERG: Yes, I would say so. I am not an expert on the daily management of the Riksbank. I am not in a position to say exactly how they work. I worked once in the Riksbank, but in a rather inferior position, so I do not know how it

COMMISSIONER GIBSON: It is just a little group around the governor who are the people who really make monetary policy? You mentioned the governor as being somebody outside, as a rule?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER GIBSON: But who actually formulates monetary policy from week to week and month to month? Is there an executive committee around him?

PROFESSOR LUNDBERG: Yes. There is an executive committee, with a chairman, the governor being the chairman; and there is a vice-governor, and there is a deputy from the board also. They are working together and meet each day and formulate and carry out the current policy, and the whole board meets once a week. A discount rate change can only happen at a certain weekday, because that decision has to be taken by the board, after consultation with the government. But there is an expert executive committee, as you would call it, taking a stand and managing the current policy.

COMMISSIONER GIBSON: Is there a group of officials within the organization who constantly discuss the matters and submit recommendations to the governor and board?

PROFESSOR LUNDBERG: Yes, I would say so. I am not an expert on the daily management of the Riksbank. I am not in a position to say exactly how they work. I worked once in the Riksbank, but in a rather inferior position, so I do not know how it

really happens. However, this executive committee is just managing as any private company is managed, by the expert people. The broader general problems are taken up by the board, whether they are political possibilities or impossibilities. But management is going on in a closer circle, where expert people are dealing with the problems.

COMMISSIONER GIBSON: What would you say about the decisions as to which way monetary policy should go at a given time -- are there any ideas coming from among the staff?

PROFESSOR LUNDBERG: Yes. But it is always difficult to judge exactly how outside people being experts and having special departments in the Riksbank will take up issues with the governor, so that things are thought over and initiatives are taken. But this can also come from the government. The finance minister especially is in contact with the broader issues and will discuss the matter with the governor. It is quite informal on that level of considering the problems.

In parliament there is a special committee of politicians watching monetary policy and how the Riksbank is governed. They have discussions and go over all the evidence of what the Riksbank has done during the last year. They present to parliament a survey and their opinions and criticisms of how the Riksbank has been applying its means and resources.

[illegible]
is just managing as any private company is managed by the expert people. The broader general problems are taken up by the board, whether they are political possibilities or impossibilities. But management is going on in a closer circle, where expert people are dealing with the problems.

COMMISSIONER GIBSON: What would you say about the decisions as to which way monetary policy should go at a given time -- are there any ideas coming from among the staff?

PROFESSOR LUNDBERG: Yes. But it is always difficult to judge exactly how outside people being experts and having special departments in the Riksbank will take up issues with the governor, so that things are thought over and initiatives are taken. But this can also come [illegible] especially is in contact with the broader issues and will discuss the matter with the governor. It is quite informal on that level of considering the [illegible]

In parliament there is a special committee of politicians watching monetary policy and how the Riksbank is governed. They have discussions and go over all the evidence of what the Riksbank has done during the last year. They present to parliament a survey and their opinions and criticisms of how the Riksbank has been applying its means and resources.

COMMISSIONER BROWN: Could you describe to us the extent of the open market operations that the bank undertakes, and do they normally operate on a bills only or a bills preferably policy, or do they have a process of operating through the whole spectrum of maturities?

PROFESSOR LUNDBERG: Yes, they operate on the spectrum of all maturities. If the Riksbank, in co-operation with the nationaldebt office, buys or sells short or long term bonds, that is quite an open question, depending on the situation. There is no prevalent theory in Sweden of the preference of only acting on the short end at all.

COMMISSIONER BROWN: Have you yourself got any thoughts on this?

PROFESSOR LUNDBERG: Well, I am no expert in that field. I think you must consider that in a country like Sweden, the credit or money market or capital market is very imperfect and narrow, there are sixteen commercial banks -- five big ones.

COMMISSIONER BROWN: Could you describe to us the extent of the open market operations that the bank undertakes, and do they normally operate on a bills only or a bills preferably policy, or do they have a process of operating through the whole spectrum of maturities?

PROFESSOR LUNDBERG: [illegible] on the spectrum of all maturities. If the Riksbank, in co-operation with the nationaldebt office, buys or sells short or long term bonds, that is quite an open question, depending on the situation. There is no prevalent theory in Sweden of the preference of only acting on the short end at all.

COMMISSIONER BROWN: Have you yourself got any thoughts on this?

PROFESSOR LUNDBERG: Well, I am no expert in that field. I think you must consider that in a country like Sweden, the credit or money market or capital market is very imperfect and narrow. There are sixteen commercial banks -- five big ones.

There are no traditional dealers in bills or securities along the lines of the big countries, and there are many personal relationships, and so on, and a big pension fund operating on the market. All this means that we have little reason to believe in any impersonal market mechanism where market forces operate along the lines of the bills only doctrine.

I think the government is correct when it likes to directly influence the long-term as well as the short-term interest by direct operations. Now, the Swedish market is so imperfect that when the discount rate is changed, as a signal of the changing of the intentions of the Riksbank, there is usually no need as to market operations in order to get the whole structure of interest rates to follow up. It is a habit, more or less, that commercial banks and savings banks all follow up with about the same rate of interest changes. The long-term rate of interest will change in the same direction -- not exactly in the same way -- but more or less parallel over the whole field. So, it is a rather simple procedure from this point of view.

COMMISSIONER BROWN: Having control of the capital issue market makes this control that much more effective?

PROFESSOR LUNDBERG: Yes, and when new issues are allowed by the Riksbank they also determine the conditions of the issues, fitting into their plans as to the long-term rate of interest.

There are no [illegible] along the lines of the big countries, and there are many personal relationships, and so on, and a big pension fund operating on the market. All this means that we have little reason to believe in any [illegible] operate along the lines of the bills only doctrine.

I think the government is correct when it likes to directly influence the long-term as well as the short-term interest by direct operations. Now, the Swedish market is so imperfect that when the discount rate is changed, as a signal of the changing of the intentions of the Riksbank, there is usually no need as to market operations in order to get the whole structure of interest rates to follow up. It is a habit, more or less, that commercial banks and savings banks all follow up with about the same rate of interest changes. The long-term rate of interest will change in the same direction -- not exactly in the same way -- but more or less parallel over the whole field. So, it is a rather simple procedure from this point of view.

COMMISSIONER BROWN: Having control of the capital issue market makes this control that much more effective?

PROFESSOR LUNDBERG: Yes, and when new issues are allowed by the Riksbank they also determine the conditions of the issues, fitting into their plans as to the long term rate of interest.

Of course, there is always some kind of outlook on the market conditions: they have to have some kind of contacts with what the insurance companies and pension funds are doing, and their willingness and what they would accept. There is always some kind of notice taken of the market conditions even if the market conditions are the result of the policy carried out. During the last years the views of the director of the big government pension fund are very determining -- as to the conditions of the issues. His views are determined by his own supply of funds in relation to what kind of material is available in the short run, and his views have some effect on the conditions laid down. But in the little longer run these conditions will be changed or modified with the help of the government policy.

COMMISSIONER BROWN: It is a picture of a very well controlled market.

PROFESSOR LUNDBERG: Well controlled from the point of view of the change of the rate of interest, yes.

COMMISSIONER BROWN: You mentioned the bank interest rates are tied by practice to changes in the bank rate: is there any statutory limitation on bank charges or bank interest rates?

PROFESSOR LUNDBERG: No, there are none of that kind. They are completely free, except, as I described this morning, there is a law in the background, but in actual fact there are no ceilings on lending

Of course, there is always some kind of outlook on the market conditions: they have to have some kind of contacts with what the insurance companies and pension funds are doing, and their willingness and what they would accept. There is always some kind of notice taken of the market conditions even if the market conditions are the result of the policy carried out. During the last years the views of the director of the big government pension fund are very determining -- as to the conditions of the issues. His views are determined by his own supply of funds in relation to what kind of material is available in the short run, and his views have some effect on the conditions laid down. But in the little longer run these conditions will be changed or modified with the help of the government policy.

COMMISSIONER BROWN: It is a picture of a very well controlled market.

PROFESSOR LUNDBERG: Well controlled from the point of view of the change of the rate of interest, ---

COMMISSIONER BROWN: You mentioned the bank interest rates are tied by practice to changes in the bank rate: is there any statutory limitation on bank charges or bank interest rates?

PROFESSOR LUNDBERG: No, there are none of that kind. They are completely free, except, as I described this morning, there is a law in the background but in actual fact there are no ceilings on lending

rate or deposit rates.

There is a lot of competition in this field, although there are officially agreed rates of interest charged for different types of advances of loans -- on a minimum level. There is a scale for different kinds of mortgage loans and other kinds of securities. They are more or less officially agreed upon by the banking association in discussion after a change in the discount rate. However, when you take up loans of various kinds on risky kinds of corporations or investment projects, and so on, the banks feel rather free to take that kind of rate of interest that they see fit -- within limits, of course; but there is no ceiling on this.

COMMISSIONER BROWN: How does this operate when the banks are being squeezed? Is there a tendency for the interest rate to go higher and higher and let the interest rate make a decision as between various would-be borrowers, or do the banks ration at fairly reasonable rates of interest?

PROFESSOR LUNDBERG: You have both tendencies. You have an increase in spread between non-risk and risky loans. If a bank under heavy monetary squeeze gives a more risky loan, they will have a higher security premium than otherwise. The highest rate of interest would be higher than during non-squeeze time. On the other hand, a lot of rationing is done, but the banks will not increase the rate of interest very much. There are

rate or deposit rates.

There is a lot of competition in this field, although there are officially agreed rates of interest charged for different types of advances of loans -- on a minimum level. There is a scale for different kinds of mortgage loans and other kinds of securities. They are more or less officially agreed upon by the banking association in discussion after a change in the discount rate. However, when you take up loans of various kinds on risky kinds of corporations or investment projects, and so on, the banks feel rather free to take that kind of rate of interest that they see fit -- within limits, of course; but there is no ceiling on this.

COMMISSIONER BROWN: How does this operate when the banks are being squeezed? Is there a tendency for the interest rate to go higher and higher and let the interest rate make a decision as between various would-be borrowers, or do the banks ration at fairly reasonable rates of interest?

[illegible]

tendencies. You have an increase in spread between non-risk and risky loans. If a bank under heavy monetary squeeze gives a more risky loan, they will have a higher security premium than otherwise. The highest rate of interest would be higher than during non-squeeze time. On the other hand, a lot of rationing is done, but the banks will not increase the rate of interest very much. There are

narrow limits in this increase of the highest rate of interest -- with the guaranteed costs that are put on the loan.

COMMISSIONER BROWN: How about changes in cash reserve requirement?

PROFESSOR LUNDBERG: By the Riksbank?

COMMISSIONER BROWN: Yes.

PROFESSOR LUNDBERG: On the commercial banks: The Riksbank can agree to a special rate that is included in the law of liquidity ratios, prescribed up to 15 per cent cash ratio to total deposits, but the Riksbank has never applied this law -- not even in the form of "voluntary agreements" -- they have only used the liquidity ratio so far. It is a potential rule. Now the banks are completely free to use the cash ratio they like or which they think is good for them and are of course eager not to lose interest by keeping unnecessary cash. They keep rather low cash ratios, but they have a rather high liquidity ratio in the wider sense of the word, which they can easily transform into cash. Depending on the kind of business the bank is carrying out, you will find the cash ratios between the banks are rather different, and that is within their own management discretion. However, potentially there is a law, so that if we don't use the liquidity ratio we can use the cash ratio. Liquidity ratio is very much on the line of paying consideration to the priorities, to see to it that enough flows to government investments, and into house-financing. If we should apply

only a cash ratio the banks will be freer to apply the loans and advances and investments freely without priorities. So, we hope -- and it has been expressed from government circles -- that this cash ratio may be applied in future when it is not needed to use the more restrictive method of liquidity ratios. We think the big pension fund, which is placing its increasing volume of funds into government and housing papers, will see to it that that market is well supplied with funds, and therefore the banking system, the commercial banks, can be kept freer and be regulated just by prescribing cash ratios.

COMMISSIONER LEMAN: You said that there was quite a discrepancy in cash ratios between one institution and the other: have you observed whether within each of those institutions there is a great fluctuation in their cash reserves from one time to the other?

PROFESSOR LUNDBERG: Well, I have not observed it, but I would think there is not too much of it because I think that is the job of a bank manager and his investment men, to see to it that the bank does not lose unnecessarily too much income by unnecessarily having too much cash, depending on the kind of risks they take and the kind of opportunities for which they like to have cash. There may be fluctuations in time, but I would not think they would be very big.

COMMISSIONER GIBSON: I would like to go back to the liquidity ratio again. The liquidity ratio

only a cash ratio the banks will be freer to apply the loans and advances and investments freely without priorities. So, we hope -- and it has been expressed from government circles -- that this cash ratio may be applied in future when it is not needed to use the more restrictive method of liquidity ratios. We think the big pension fund, which is placing its increasing volume of funds into government and housing papers, will see to it that that market is well supplied with funds, and therefore the banking system, the commercial banks, can be kept freer and be regulated just by prescribing cash ratios.

COMMISSIONER LEMAN: You said that there was quite a discrepancy in cash ratios between one institution and the other: have you observed whether within each of those institutions there is a great fluctuation in their cash reserves from one time to the other?

PROFESSOR LUNDBERG: Well, I have not observed it, but I would think there is not too much of it because I think that is the job of a bank manager and his investment men, to see to it that the bank does not lose unnecessarily too much income by unnecessarily having too much cash, depending on the kind of risks they take and the kind of opportunities for which they like to have cash. There may be fluctuations in time, but I would not think they would be very big.

COMMISSIONER GIBSON: I would like to go back to the liquidity ratio -- the liquidity ratio.

includes as liquid assets, does it, all forms of government securities?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER GIBSON: Including monies for housing guaranteed by government.

PROFESSOR LUNDBERG: Yes, bonds issued by these institutions which work with a government guarantee; and the foreign exchange is also included, that the banks might have.

COMMISSIONER GIBSON: The way you put it I rather got the idea that the philosophy of the liquidity ratio was to see the banks put enough of their resources into government sponsored things rather than to limit the amount of the resources that went into the private sector: is that a correct statement?

PROFESSOR LUNDBERG: I would not put it so. Why could we not say it is both?

COMMISSIONER GIBSON: Well, I just want to ask you.

PROFESSOR LUNDBERG: If we are in a position where we are afraid of over-investment -- excess demand in our economy -- we like to try to depress this kind of boom by limiting the availability of finances for these investments. At the same time we like to preserve government investments and investments in housing from this squeeze. Then, we do both: we preserve, and see to it that not too much of this pressure occurs on these fields of priority, and that the squeeze falls on the rest of the economy. Therefore, I would say in answer to your

includes as liquid assets, does it, all forms of
government guaranties?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER GIBSON: Including monies for housing guaranteed by government.

PROFESSOR LUNDBERG: Yes, bonds issued by these institutions which have this government guarantee; and the foreign exchange is also included, that the banks might have.

COMMISSIONER GIBSON: The way you put it, I rather got the idea that the philosophy of the liquidity ratio was to see the banks put enough of their resources into government sponsored things rather than to limit the amount of the resources that went into the private sector. Is that a correct statement?

PROFESSOR LUNDBERG: I would not put it so. Why could we not say it is both?

COMMISSIONER GIBSON: Well, I just want to get it.

PROFESSOR LUNDBERG: If we are in a position where we are afraid of over-investment -- excess demand in our economy -- we like to try to depress this kind of boom by limiting the availability of finances for these investments. At the same time we like to preserve government investments and investments in housing from this squeeze. Then, we do both: we preserve, and see to it that not too much of this pressure occurs on these fields of priority, and that the squeeze falls on the rest of the economy. Therefore, I would say in answer to your

question that we are in those conditions aiming at both these things.

COMMISSIONER GIBSON: Surely it has little to do with bank liquidity.

PROFESSOR LUNDBERG: It is a very bad word, isn't it? It is a misuse of the word liquidity, and I think the wording should be changed, because it is really not liquidity in any sensible interpretation of the word. However, it has entered into the law and it has been accepted and it is difficult to change it. Foreign students of Swedish banking may misinterpret it and find it strange.

COMMISSIONER GIBSON: I think the idea is held elsewhere too.

COMMISSIONER BROWN: Are the government accounts kept in commercial banks as well as the Riksbank, or only at the central bank?

PROFESSOR LUNDBERG: If you are speaking about the administration units of the government, all their accounts are kept in the Riksbank and their offices around the country. Then we have, of course, state corporations such as the water power board, and the state railroads, and so on -- the commercial kind of non-corporation units -- that are very big and important, and they keep all their money in the state commercial bank. There is a state commercial bank -- a very big bank -- which was created some years ago, and these units have to keep their money in that bank for current purposes.

COMMISSIONER BROWN: Does this bank do ordinary

[illegible] these things.

COMMISSIONER GIBSON: Surely it has little [illegible].

[illegible]: It is a very bad word, isn't it? It is a misuse of the word liquidity, and I think the wording should be changed, because it is really not liquidity in any sensible interpretation of the word. However, it has entered into the law and it has been accepted and it is difficult to change it. Foreign students of Swedish banking may misinterpret it and find it strange.

COMMISSIONER GIBSON: I think the idea is held elsewhere too.

COMMISSIONER BROWN: Are the government accounts kept in commercial banks as well as the Riksbank, or only at the central bank?

PROFESSOR LUNDBERG: If you are speaking about the administration units of the government, all their accounts are kept in the Riksbank and their offices around the country. Then we have, of course, state corporations such as the water power board, and the state railroads, and so on -- the commercial kind of non-corporation units -- that are very big and important, and they keep all their money in the state commercial bank. There is a state commercial bank -- a very big bank -- which was created some years ago and these units have to keep their money in that bank for current purposes.

COMMISSIONER BROWN: Does this bank do ordinary [illegible]

commercial business as well?

PROFESSOR LUNDBERG: Yes, it is very active. It is so competitive, and they have a management and a director who is just dangerous as far as the others are concerned. He is carrying on without direct profit motives or anything like that with great energy. You will find lots of complaints about the state commercial bank in this private business. Some say that by getting all this government money, it is favoured. The state bank takes part only as sleeping partner in the bank association meetings in the forming of rates of interest and so on. The bank seems always on the point of breaking agreements and is in all ways very competitive, with branch offices and new innovations in the banking field. We think the state bank, if it has no other special favours should act competitively.

COMMISSIONER BROWN: Does it get squeezed the same as the others?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER BROWN: Does it pay income tax?

PROFESSOR LUNDBERG: Oh, yes.

COMMISSIONER BROWN: Has it been growing at the expense of the ordinary commercial banks?

PROFESSOR LUNDBERG: Yes, in a way it has been growing more rapidly than the others during these years, partly because of getting during this time funds from the government enterprises, and partly also, I think, as a result of direct competitive leadership.

mercial business as well?

PROFESSOR LUNDBERG: Yes, it is very active. It is so competitive, and they have a management and a director who is just dangerous as far as the others are concerned. He is carrying on without direct profit motives or anything like that with great energy. You will find lots of complaints about the state commercial bank in this private business. Some say that by getting all this government money, it is favoured. The state bank takes part only as sleeping partner in the bank association meetings in the forming of rates of interest and so on. The bank seems always on the point of breaking agreements and is in all ways very competitive, with branch offices and new innovations in the banking field. We think the state bank, if it has no other special favours should act competitively.

COMMISSIONER BROWN: Does it get squeezed the same as the others?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER BROWN: Does it pay income tax?

PROFESSOR LUNDBERG: Oh, yes.

COMMISSIONER BROWN: Has it been growing at the expense of the ordinary commercial banks?

PROFESSOR LUNDBERG: Yes, in a way it has been growing more rapidly than the others during these years, partly because of getting during this time funds from the government enterprises, and partly also,

[illegible]

People mostly are sorry both if a state enterprise is operating badly and declines and also if it is efficient and competitive and grows. However, if you have to make a choice, I think it is better to have an effectively managed and energetic lead state company, provided it is not getting special favours and subsidies.

THE CHAIRMAN: Do you happen to know offhand what is the average maturity of the long-term debt?

PROFESSOR LUNDBERG: No, I have not the figures here.

THE CHAIRMAN: It may not be too important; I was just interested.

PROFESSOR LUNDBERG: We have a rather small total government debt. It is just one quarter of the gross national product. I think the English have one and a half times the gross national product. So, it does not bother us, so much,and the debt management has not been the same type of severe problem as in other countries. Sweden did not take part in the wars, and have not that type of problem to the same extent as in so many other countries, and therefore our total debt is not so high.

However, I presume a relatively large part is funded debt, more than 10 years, or something like that; but I could not say exactly how much of it.

THE CHAIRMAN: You mentioned, I think, at an earlier stage that there are certain institutions which you call near banks in Sweden. Have you any

People mostly are sorry both if a state enterprise is operating badly and declines and also if it is efficient and competitive and grows. However, if you have to make a choice, I think it is better to have an effectively managed and energetic lead state company, provided it is not getting special favours and subsidies.

THE CHAIRMAN: Do you happen to know off-hand what is the average maturity of the long-term [illegible]

PROFESSOR LUNDBERG: No, I have not the [illegible]

THE CHAIRMAN: It may not be too important; I was just interested.

PROFESSOR LUNDBERG: We have a rather small total government debt. It is just one quarter of the gross national product. I think the English have one and a half times the gross national product. So, it does not bother us, so much and the debt management has not been the same type of severe problem as in other countries. Sweden did not take part in the wars, and have not that type of problem to the same extent as in so many other countries, and therefore our total debt is not so high.

[illegible] is funded debt, more than 10 years, or something like that; but I could not say exactly how much of it.

THE CHAIRMAN: You mentioned, I think, at an earlier stage that there are certain institutions which you call near banks in Sweden. Have you any

means of controlling their activities, or do you attempt to do that at all?

PROFESSOR LUNDBERG: I think our definitions of "near banks" is not so very clear. You would not call a savings bank a near bank; it is just a bank.

THE CHAIRMAN: Well, finance companies: are these hire-purchase companies in Sweden?

PROFESSOR LUNDBERG: We have hire-purchase institutions.

THE CHAIRMAN: Do they finance consumer goods?

PROFESSOR LUNDBERG: Yes, and discount the bills of the traders in these fields, and it is a growing business in Sweden.

THE CHAIRMAN: Do you regard it as a problem at all?

PROFESSOR LUNDBERG: We have problems with them. We like to have problems; that is creating progress. I think competition in this field is good, but the big difference from the Canadian and American situation is that these institutions have not the right to accept deposits. That is themain difference, and therefore they have not this position of near banks. These institutions get nearly all of their money by discounting bills with the commercial banks, and they get their funds mainly from the commercial banks. So, the commercial banks are advancing with the help of these organizations of various types.

means of controlling their activities, or do you attempt to do that at all?

PROFESSOR LUNDBERG: I think our definition of "near banks" is not so very clear. You would not call a savings bank a near bank; it is just a bank.

THE CHAIRMAN: Will [illegible] are these hire-purchase companies in Sweden?

PROFESSOR LUNDBERG: We have hire-purchase institutions.

THE CHAIRMAN: Do they finance consumer goods?

PROFESSOR LUNDBERG: Yes, and discount the bills of the traders in these fields, and it is a growing business in Sweden.

THE CHAIRMAN: Do you regard it as a problem at all?

PROFESSOR LUNDBERG: We have problems with them. We like to have problems; that is creating progress. I think competition in this field is good, but the big difference from the Canadian and American situation is that these institutions have not the right to accept deposits. That is themain difference, and therefore they have not this position of near banks. These institutions get nearly all of their money by discounting bills with the commercial banks, and they get their funds mainly from the commercial banks. So, the commercial banks are advancing with the help of these organizations of various types.

THE CHAIRMAN: Do you have any powers to control their activities in any way?

PROFESSOR LUNDBERG: Yes, that has been more or less so from the beginning, that the Board of Trade has limited rights to prescribe the cash payments and the maturity of instalment credits -- the length of the contract in these fields. This right of prescription hasn't been used as in England as a current policy measure. Our experience is that when the Riksbank squeezes the commercial banks that that works back on the bank credit to instalment credit firms because they get the money from the commercial banks. We have, therefore, not from this point of view had the same problem as you have had. With relation to the savings banks, the farmer credit institutions and the insurance companies, and so on there are possibilities of regulation according to the law to prescribe both liquidity ratios of a type but which are not so high as for the commercial banks, and also there are in the law possibilities of prescribing what we call investment quotas so that insurance companies, and so on, have -- during those times when this law is applied -- to use up to 80 per cent, I think, of the increase of these funds during a certain time for a priority investment in government papers and in the housing financing bonds. Potentially the government or the Riksbank can therefore prescribe the same kind of pressure on these other types of institutions.

THE CHAIRMAN: Do you have any powers to control their activities in any way?

PROFESSOR LUNDBERG: Yes, that has been more or less so from the beginning, that the Board of Trade has limited rights to prescribe the cash payments and the maturity of instalment credits -- the length of the contract in these fields. This right of prescription hasn't been used as in England as a current policy measure. Our experience is that when the Riksbank [illegible] on the bank credit to instalment credit firms because they get the money from the commercial banks. -- We have, therefore, not from this point of view had the same problem as you have had. With relation to the savings banks, the farmer credit institutions and the insurance companies, and so on there are possibilities of regulation according to the law to prescribe both liquidity ratios of a type but which are not so high as for the commercial banks, and also there are in the law possibilities of prescribing what we call investment quotas so that insurance companies, and so on, have -- during those times when this law is applied -- to use up to 50 per cent, I think, of the increase of these funds during a certain time for a priority investment in government papers and in the housing financing bonds. Potentially the government or the Riksbank can therefore prescribe the same kind of pressure on these other types of [illegible]

Now, this law has never been applied and I doubt it will be applied; it is only, again, the background for making "voluntary agreements" with these institutions. Already before this law existed the Riksbank made agreement with the insurance companies, for instance, as to helping the commercial banks and the other institutions in placing their funds into the priority sectors of the economy. So from this point of view the commercial banks have not felt that they alone have been under pressure during times of monetary suqeeze.

However, it is true in Sweden, as in Canada, that the commercial banks have been under more pressure during monetary suqeeze times than the other institutions. It is quite natural that that happens. On the other hand, there are also times when there has been no pressure or monetary squeeze and the commercial banks have been growing more rapidly than the other institutions, so it has been evened up over the years.

THE CHAIRMAN: Well, from the point of view of monetary policy would you think that there would be need to regulate some of these near banks, such as we have in this country, on a fairly large scale; to regulate them so that their activities may be cut down at certain times and allowed to expand at other times, consistent with your general monetary policy?

Now, this law has never been applied and I doubt it will be applied; it is only, again, [illegible] these institutions. Already before this law existed the Riksbank made agreement with the insurance companies, for instance, as to helping the commercial banks and the other institutions in placing their funds into the priority sectors of the economy. So from this point of view the commercial banks have not felt that they alone have been under pressure during times of monetary [illegible].

However, it is true in Sweden, as in Canada, that the commercial banks have been under more pressure during monetary squeeze times than the other institutions. It is quite natural that that happens. On the other hand, there are also times when there has been no pressure or monetary squeeze and the commercial banks have been growing more rapidly than the other institutions, so it has been evened up over the years.

THE CHAIRMAN: Well, from the point of view of monetary policy would you think that there would be need to regulate some of these near banks, such as we have in this country, on a fairly large scale; to regulate them so that their activities may be cut down at certain times and allowed to expand at other times, consistent with your general monetary policy?

PROFESSOR LUNDBERG: Are you speaking of Sweden or Canada?

THE CHAIRMAN: It perhaps would apply more to Canada than to Sweden, according to what you have said about the Swedish situation at the present time, because here we have credit unions which have very large funds that have been built up over the years, and they borrow and they lend money ---

PROFESSOR LUNDBERG: Yes.

THE CHAIRMAN: I don't know whether it is fair to ask you whether you think ---

PROFESSOR LUNDBERG: I am just an irresponsible professor; I am not afraid of answering questions!

THE CHAIRMAN: I was asking you this; I put this question to you as an economist, not as a professor.

PROFESSOR LUNDBERG: I don't know the differenct but, anyhow, my personal view is that if your near banks are of that character as I have read about in your documents, that they accept deposits, I would consider them as banks, and I would say that to me it is strange in not applying the same rules to all the banks accepting deposits and putting them under the equal squeeze. Our problem is very different, as these other credit institutions don't receive deposits and are not like banks, having the facilities of a bank.

PROFESSOR LUNDBERG: [illegible] speaking

of [illegible] Canada.

THE CHAIRMAN: It perhaps would apply more to Canada than to Sweden, according to what you have said about the Swedish situation at the present time; [illegible] which have very large funds that have been built up over the years, and they borrow and they lend money ---

PROFESSOR LUNDBERG: Yes.

THE CHAIRMAN: I don't know whether it is fair to ask you whether you think ---

PROFESSOR LUNDBERG: I am just an irresponsible professor; I am not afraid of answering questions!

THE CHAIRMAN: I was asking you this; I put this question to you as an economist, not as a professor.

PROFESSOR LUNDBERG: I don't know the difference but, anyhow, my personal view is that if your near banks are of that character as I have read about in your documents, that they accept deposits, I would consider them as banks, and I would say that to me it is strange in not applying the same rules to all the banks accepting deposits and putting them under the equal squeeze. Our problem is very different, as these other credit institutions don't receive deposits and are not like banks, having the facilities of a bank.

I can't understand your ceiling rates, neither; I think that is very strange, applying it sometimes on banks you call commercial but not on other types you don't call banks. Such things I don't understand. That is as difficult for me to understand as you have of understanding some of our ways of doing things; I am sure we all have our own idiosyncrasies.

THE CHAIRMAN: That is one of our problems. Now, there is one last question which I would like to ask and that is in connection with the international exchange rate. You have to fix your floating rate, or something in between?

PROFESSOR LUNDBERG: We have a fixed rate according to the monetary fund rules and, we have a discussion on the flexible rate on a very academic level but never as a practical policy issue. We devalued our crown following the British pound in 1949, and since then we have kept a stable value on the Swedish crown, much under-valued during that time; we got perhaps some of our inflation out of that but we also got a relatively favourable position for our export industries and some protection for home goods industries, thanks to this kind of under-valuation of the crown. But, again from the point of view of the aim of preserving the value of money, it was bad because it created an increase of import and export prices that resulted in our rapid increase of the price level.

COMMISSIONER MACKINTOSH: I would like to

I don't understand your ceiling rates, neither; I think that is very strange, applying it sometimes on banks you call commercial but not on other types you don't call banks. Such things I don't understand. That is as difficult for me to understand as you have of understanding some of our ways of doing things; I am sure we all have our own old approaches.

THE CHAIRMAN: That is one of our problems. Now, there is one last question which I would like to ask and that is in connection with the international exchange rate. You have to fix your floating rate, or something in between?

PROFESSOR LUNDBERG: We have a fixed rate according to the monetary fund rules and, we have a discussion on the flexible rate on a very academic level but never as a practical policy issue. We devalued our crown following the British pound in 1949, and since then we have kept a stable value on the Swedish crown, much under-valued during that time; we got perhaps some of our inflation out of that but we also got a relatively favourable position for our export industries and some protection for home goods industries, thanks to this kind of under-valuation of the crown. But, again from the point of view of the aim of preserving the value of money, it was bad because it created an increase of import and export prices that resulted in our rapid increase of the price level.

COMMISSIONER MACKINTOSH: I would like to

get a clearer idea of some of your monetary devices and the patterns of action which you took. You mentioned this morning the 12 per cent investment tax which was put in in 1955. Does this mean 12 per cent on the investment expenditure?

PROFESSOR LUNDBERG: Yes. You know, I should be more specific, perhaps, than that; it was 12 per cent on expenditure of investment in buildings, machinery and similar expenditures, not on investment in stocks or inventories, and there was a limit of 20,000 crowns, so that there was -- a deduction of 20,000 crowns; firms having less investment didn't pay the tax at all.

COMMISSIONER MACKINTOSH: Was there prior legislation which enabled the government to impose this tax quickly?

PROFESSOR LUNDBERG: No, there has to be a new law for each time. The government proposal has to go through the whole process of a proposition to parliament and be put into force. But, having a socialistic government during these years and relying on the majority that can be mobilized in parliament, it is a very quick affair of a fortnight to put an investment tax into effect. The main thing I have stressed in this memo on the investment tax was the experience of industry that this was never intended to be a permanent tax.

We often do not believe in finance ministers when they say that this is a tax just for a short time, because there is so much bad experience with

get a clearer idea of some of your monetary devices and the patterns of action which you took. You mentioned this morning the 12 per cent investment tax which was put in in 1955. Does this mean 12 per cent on the investment expenditure?

PROFESSOR LUNDBERG: Yes. You know, I should be more specific, perhaps, than that; it was 12 per cent on expenditure of investment in buildings, machinery and similar expenditures, not on investment in stocks or inventories, and there was a limit of 20,000 crowns, so that there was -- a deduction of 20,000 crowns; firms having less investment didn't pay the tax at all.

[illegible] legislation which enabled the government to impose this tax quickly?

PROFESSOR LUNDBERG: No, there has to be a new law for each time. The government proposal has to go through the whole process of a proposition to parliament and be put into force. But, having a socialistic government during these years and relying on the majority that can be mobilized in parliament, it is a very quick-affair of a fortnight to put an investment tax into effect. The main thing I have stressed in this memo on the investment tax was the experience of industry that this was never intended to be a permanent tax.

We often do not believe in finance ministers when they say that this is a tax just for a short time, because there is so much bad experience with

finance ministers all over the world, that when a tax is introduced it tends to be permanent as it is needed. But in this case industry had the experiences of this tax being introduced and taken away, so they believe in it, and therefore there was a kind of expectation that it would disappear after the boom, and that is where we get the postponement effect. Had people believed that this was a permanent tax it would have been built into our price system and just made our economy still more inflationary.

COMMISSIONER MACKINTOSH: It was a very powerful weapon to wield.

PROFESSOR LUNDBERG: Yes, and it was not popular, you know! Anyhow, from the socialist point of view it is in a way the most wonderful kind of an expedient. You know, in our investment boom one likes to make investment expenditure more expensive than otherwise would be the case. An increase in the rate of interest very much means from the socialist point of view -- that a lot of people get more income out of the higher yields and the higher rates of interest in the economy, but in this way it was an increase in investment costs without anybody getting any higher income out of it. I know from interviews with government people that many people would like to use the method again in a new boom. It is a very efficient kind of an arrangement and it may be enforced very quickly and it may be

taken away again very quickly.

You discuss in this country and in the United States so much the devastating effect on your capital markets and of large increases of long term interest rates that will create quite embarrassing situations, as was the case in 1958. This investment tax has no effects along this line; it works completely independently on the prices of the bonds in the capital markets, and this is something appealing from this point of view, that there is no confiscation of fortunes of people. From the point of view of your way of doing things -- if the interest rates were raised very rapidly, if you thought of that two or three per cent, the average of the prices on the bonds would mean a radical confiscation of people's fortunes. What is more socialistic our ways or yours, I don't know.

COMMISSIONER MACKINTOSH: I see your logic, but I haven't much hope of officially protesting against high interest rates.

PROFESSOR LUNDBERG: The interesting thing as I see it is that it is the socialist people and the trade union people who are supporting the government in this field; they are more in favour of using the investment reserves or the investment fund policy than the investment tax, although the investment fund way of doing things is very favourable to private corporations.

COMMISSIONER MACKINTOSH: I wanted to clarify the investment reserve policy a bit, which I found to be a very interesting device. This is essentially the setting aside of profits without tax into a reserve which can be used only when the labour market board says it can be released. I don't quite understand the later period here where you mention -- well, there are two points; one, they are required to deposit roughly the tax part of this in the Riksbank?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER MACKINTOSH: There was inducement to them to deposit more than that, and there was also reference to a further 10 per cent -- was it a tax? It is on page 13, and this is the sentence which begins at the bottom of page 12:

> "An extra stimulus to use this device is given by a 10 per cent deduction from taxable profits of the investment fund used."

PROFESSOR LUNDBERG: Yes.

COMMISSIONER MACKINTOSH: This applies only when the funds are released ---

PROFESSOR LUNDBERG: And used, yes.

COMMISSIONER MACKINTOSH: And then they can write off 10 per cent of it against the profits of that year?

PROFESSOR LUNDBERG: Yes and if the corporation, as is the case -- just now in these current months the labour market board has given corporations the right

COMMISSIONER MACKINTOSH: I wanted to clarify the investment reserve policy a bit, which I found to be a very interesting device. This is essentially the setting aside of profits without tax into a reserve which can be used only when the labour market board says it can be released. I don't quite understand the later period here where you mention -- well, there are two points; one, they are required to deposit roughly the tax part of this in the Riksbank?

[illegible]

COMMISSIONER MACKINTOSH: There was inducement to them to deposit more than that, and there was also reference to a further 10 per cent -- was it a tax? It is on page 13, and this is the sentence which begins at the bottom of page 12:

"An extra stimulus to use this device [illegible] taxable profits of the investment fund used."

PROFESSOR LUNDBERG: Yes.

COMMISSIONER MACKINTOSH: This applies only when the funds are released ---

PROFESSOR LUNDBERG: And used, yes.

COMMISSIONER MACKINTOSH: And then they can write off 10 per cent of it against the profits of that year?

PROFESSOR LUNDBERG: Yes and if the corporation, as is the case just now in these current months the labour market board has given corporations the right

to use the investment funds for writing off investments, and it applies during the year and up to May of next year. If, for instance, a corporation uses investment funds up to one million crowns, it could have the right to use 10 per cent of this, or 100 thousand crowns, to deduct from its profits for taxation. That is an extra stimulus in that way.

In a new proposal it is now suggested -- this system of investment funds has been worked over by a committee -- this extra deduction of ten per cent of the investment fund used will be eliminated because they consider that this free rate of writing off building expenditure is enough stimulus. There has been a big wave of applications for using investment funds during this year. This use of investment funds is really a very liberal way of being able to write off buildings that otherwise would have to be written off in 33 years' time, and which now can be written off immediately.

COMMISSIONER MACKINTOSH: Does this apply to corporations and also to small businesses?

PROFESSOR LUNDBERG: It applies to corporations and what we call economic unions which are not the ordinary corporate kind of firms.

COMMISSIONER LEMAN: Co-operatives?

PROFESSOR LUNDBERG: Partnerships. Firms that set aside investment funds can deduct these from the profits, and therefore they get the right to write off investments that they are not allowed to make until later. The National Labour Board gives that allowance during a recession. In order to neutralize that liquidity effect the corporation has to pay part of the fund (46 per cent) into the Riksbank and thus sterilize it for

In a new proposal it is now suggested -- this system of investment funds has been worked over by a committee -- this extra deduction of ten per cent of the investment fund used will be eliminated because they consider that this free rate of writing off building expenditure is enough stimulus. There has been a big wave of applications for using investment funds during this year. This use of investment funds is really a very liberal way of being able to write off buildings that otherwise would have to be written off in 33 years' time, and which now can be written off immediately.

[illegible] apply to corporations and also to small [illegible]

PROFESSOR LUNDBERG: It applies to corporations and what we call economic unions which are not the ordinary corporate kind of firms.

COMMISSIONER LEMAN: Co-operatives?

[illegible] that set aside investment funds can deduct these from the profits, and therefore they get the right to write off investments that they are not allowed to make until later. The National Labour Board gives that allowance during a recession. In order to neutralize that liquidity effect the corporation has to pay part of the fund (46 per cent) into the Riksbank and thus sterilize it for

the time being. Corporations are allowed to set off an amount corresponding to 40 per cent of the profits.

COMMISSIONER LEMAN: Professor Lundberg, in granting permission for the use of these investment reserve funds does the board again have the chance of being selective?

PROFESSOR LUNDBERG: No, it does not. There are two features of this law that I have not mentioned. One is that it is possible to make it compulsory. The Labour Market Board can say that during this time all corporations which have set off investments funds must use parts of them for investment expenditures, otherwise this part will be made subject to taxation. This compulsory provision has never been used, and it has not been necessary to use, but one can imagine the situation when the list of the entrepreneurs wanting to use the funds is low: when there is a depression there may be a need to use the compulsory part of it. So far as I know from speaking to the people who manage this kind of policy, they have no intention of using this provision. They cannot imagine a situation where the compulsory part will be used.

COMMISSIONER MACKINTOSH: It would hardly ensure a perfect allocation of resources?

PROFESSOR LUNDBERG: No, but it is not

the time being. Corporations are allowed to set off an amount corresponding to 40 per cent of the profit.

COMMISSIONER LEMAN: Professor Lundberg, in granting permission for the use of these investment reserve funds does the board again have the chance of being selective?

PROFESSOR LUNDBERG: [illegible] There are two features of this law that I have not mentioned. One is that it is possible to make it compulsory. The Labour Market Board can say that during this time all corporations which have set off investments funds must use parts of them for [illegible] be made subject to taxation. This compulsory provision has never been used, and it has not been necessary to use, but one can imagine the situation when the list of the entrepreneurs wanting to use the funds is low: when there is a depression there may be a need to use the compulsory part of it. So far as I know from speaking to the people who manage this kind of policy, they have no intention of using this provision. They cannot imagine a situation where the compulsory part will be used.

COMMISSIONER [illegible] hardly ensure a perfect allocation of resources?

PROFESSOR LUNDBERG: No, but it is not

a very bad measure. We have a lot of corporations who avoid the taxation, but now we are making them pay the tax. They have to make the investment or pay the tax. They have the choice. As it is now I think there are up to a thousand corporations applying to use their investment reserve funds, and they have to make it clear that the use of these funds means investments being made that would not otherwise have been made. That is, of course, not so easy, and we are sure that a lot of investment made would be made anyhow.

The taxation authority looks the matter over and controls the expenditures, and sees to it that they are made during a time when the labour board considers there are recessional problems. The labour board has now limited the period up to May of 1963 because it knows that during the summer there will anyhow be lots of employment possibilities in the Swedish economy.

There is the possibility, according to this law, of applying it discriminately so that it will apply to special sectors of the country where there are special recessional tendencies. This would be applicable to the Swedish situation now. In the north of Sweden there is more of a recession than in the south. A recession is expected there because of difficulties in the pulp and paper industries, and especially in forestry, so that actually the national labour board should

have this benefit of allowing investment funds of corporations in the north of Sweden to be used. They have considered this and discussed it with the government. But the problem is that the corporations in the north of Sweden are having difficulties already in selling and having surplus capacity, so that being so the use of funds would not have great results.

The labour board also considers it not good to use the law in a discriminatory way because there are always difficulties with respect to boundary lines. People will lose confidence in the use of this measure with respect to investment funds if during certain times one corporation situated in one place has advantages over a corporation situated elsewhere. They like to use the measure as generally as possible at any given time. Now that they have made its use applicable to the whole of the Swedish economy we are getting a building boom in the south of Sweden. There are not enough building workers in the south. A number of corporations are getting on with the building of new plants to quite an extent in the south of Sweden. The consequence is that now we are encountering the problem we discussed this morning. The national labour board, with the help of its local authorities, has to see to it that building workers, or people who are able to do building work , thanks to some vocational training, are transferred from the north of Sweden to the south.

have this benefit of allowing investment funds of corporations in the north of Sweden to be used. They have considered this and discussed it with the government. But the problem is that the corporations in the north of Sweden are having difficulties already in selling and having surplus capacity, so that being so the use of funds would not have great results.

The labour board also considers it not good to use the law in a discriminatory way because there are always difficulties with respect to boundary lines. People will lose confidence in the use of this measure with respect to investment funds if during certain times one corporation situated in one place has advantages over a corporation situated elsewhere. They like to use the measure as generally as possible at any given time. Now that they have made its use applicable to the whole of the Swedish economy we are getting a building boom in the south of Sweden. There are not enough building workers in the south. A number of corporations are getting on with the building of new plants to quite an extent in the south of Sweden. The consequence is that now we are encountering the problem we discussed this morning. The national labour board, with the help of its local authorities, has to see to it that building workers, or people who are able to do building work, thanks to some vocational training, are transferred from the north of Sweden to the south.

So, this stimulation of the economy by using the investment funds is closely connected with a policy of moving workers who are unemployed during the winter season in the north of Sweden to parts of the country where they can be employed. That is a rather new feature to this extent, that the policy is to use people who are not yet unemployed, but who expect to be unemployed. By means of the warning system the Board knows that building work will release labour within so many months, and these people are already prepared. This is a very ambitious kind of policy, and we do not know to what extent it will be effective. But it illustrates the difficulty faced by a small country like Sweden where the tendencies towards development are uneven in the various regions. If you apply global methods to the whole of the economy you get into difficulties, and, therefore, you must supplement this measure by some means of getting workers moving out of regions of low demand into regions of high demand.

COMMISSIONER LEMAN: Perhaps we can come back for a moment to the 12 per cent investment tax. You have described it here, and you say it was a levy of 12 per cent on capital expenditures above a certain minimum. Was it applied without any administrative system? Was it absolutely automatic? Suppose a company had already embarked on a certain expansion program when this came into effect? Did the 12 per cent automatically apply, or could they get exemption by proving that their project was something that was already commenced?

So, this stimulation of the economy by using the investment funds is closely connected with a policy of moving workers who are unemployed during the winter season in the north of Sweden to parts of the country where they can be employed. That is a rather new feature to this extent, that the policy is to use people who are not yet unemployed, but who expect to be unemployed. By means of the warning system the Board knows that building work will release labour within so many months, and these people are already prepared. This is a very ambitious kind of policy, and we do not know to what extent it will be effective. But it illustrates the difficulty faced by a small country like Sweden where the tendencies towards development are uneven in the various regions. If you apply global methods to the whole of the economy you get into difficulties, and, therefore, you must supplement this measure by some means of getting workers moving out of regions of low demand into regions of high demand.

COMMISSIONER LEMAN: Perhaps we can come bac for a moment to the 12 per cent investment tax. You h described it here, and you say it was a levy of 12 per cent on capital expenditures above a certain minimum. Was it applied without any administrative system? Was it absolutely automatic? Suppose a company had alrea [illegible] into effect? Did the 12 per cent automatically apply, or could they get exemption by proving that their project was something that was already commenced?

PROFESSOR LUNDBERG: No, it was applied on the expenditure during the year, but, you know, managers are usually very skilfull in getting around problems of this kind, and all kinds of allowable tricks were used by corporations in seeing to it that deliveries of machinery were accelerated or that they were postponed a little, and in this way they certainly avoided part of the tax. Things like that must happen. It is not good, of course, from the point of view of applying such a heavy tax when people can avoid it by post-dating or ante-dating things.

In the main, if you look away from such bad features of the tax, it did apply with great heaviness upon corporations, and forced them to postpone as much as possible of investment expenditures during that time. I agree that it has some of the bad features that you refer to. I think the general view is that this kind of measure should be applied only during times of extreme difficulty in managing a boom period.

We know that the investment reserve policy is not very good in dampening a boom. It is good in making managers and entrepreneurs make the investments during a recession, but putting investment reserves into the Riksbank is not a very effective method in dampening capital expenditures during a boom, in my opinion. An investment tax is much more effective from that point of view.

We had a special supplementary device during 1960-61 by which we used this investment fund technique

for mopping up surplus liquidity in the economy. That was a special feature that applied to this problem that was not thought of before, but that just complemented the measures that were applied during that period. It was rather simple to make all entrepreneurs, instead of paying in 46 per cent of the investment reserve that they allocated out of profits to stimulate them to put 100 per cent of their reserves into the Riksbank which paid them well for doing it. They were paid so well by means of extra allowances that the yield was about 9 or 10 per cent. They took the money out of the the commercial banks and deposited it in the Riksbank, and that was an open and regular operation which yielded a very high rate of interest.

COMMISSIONER LEMAN: What was the method of paying them so well?

PROFESSOR LUNDBERG: It was by this means that I mention on page 13 -- this 10 per cent deduction from taxable profits. It was calculated on what you paid into the Riksbank above what you would otherwise pay in taxes. That was applied so generously that, in fact, the yield on the money you paid into the Riksbank amounted to something approaching 10 per cent. I think it was a too expensive way of getting that done, and it also meant that the banks were suddenly squeezed out of funds that had been deposited by the corporations in previous years which had come from the budget deficits that had been financed by the commercial banks.

The bank by which I am employed as economic adviser had many large customers in industry who found

for mopping up surplus liquidity in the economy. That was a special feature that applied to this problem that was not thought of before, but that just complemented the measures that were applied during that period. It was rather simple to make all entrepreneurs, instead of paying in 45 per cent of the investment reserve that they allocated out of profits to stimulate them to put 100 per cent of their reserves into the Riksbank which paid them well for doing it. They were paid so well by means of extra allowances that the yield was about 9 or 10 per cent. They took the money out of the the commercial banks and deposited it in the Riksbank, and that was an open and regular operation which yielded a very high rate of interest.

COMMISSIONER LERMAN: What was the method of paying them so well?

PROFESSOR LUNDBERG: It was by this means that I mention on page 13 -- this 10 per cent deduction from taxable profits. It was calculated on what you paid into the Riksbank above what you would otherwise pay in taxes. That was applied so generously that, in fact the yield on the money you paid into the Riksbank amounted to something approaching 10 per cent. I think it was a too expensive way of getting that done, and it also meant that the banks were suddenly squeezed out of funds that had been deposited by the corporations in previous years which had come from the budget deficits that had been financed by the commercial banks.

The bank by which I am employed as economic adviser had many large customers in industry who found

that it was better to have the money in the Riksbank under this condition than in our bank. The Scandinaviska Banken was quickly put into a position of squeeze by this flow of funds into the Riksbank.

That shows the power ofimagination on the part of the authorities in applying a combination of fiscal and monetary policy. I do not know whether it is monetary policy or fiscal policy, but the name does not matter. Anyhow, it was a very quick way of eliminating and mopping up surplus liquidity, and in a way I consider it a little more elegant than the method applied during 1955-57 when liquidity ratios and credit ceilings were applied, and when there was a ceiling on the bank's advances. This was a more elegant or more orthodox way of doing it, although a more expensive one.

THE CHAIRMAN: We shall adjourn for a few minutes.

---A short recess.

that it was better to have the money in the Riksbank under this condition than in our bank. The Scandinavisk Banken was quickly put into a position of squeeze by this flow of funds into the Riksbank.

That shows the power of imagination on the part of the authorities in applying a combination of fiscal and monetary policy. I do not know whether it is monetary policy or fiscal policy, but the name does not matter. Anyhow, it was a very quick way of eliminating and mopping up surplus liquidity, and in a way I consider it a little more elegant than the method applied during 1955-57 when liquidity ratios and credit ceilings were applied, and when there was a ceiling on the bank's advances. This was a more elegant or more orthodox way of doing it, although a more expensive way.

THE CHAIRMAN: We shall adjourn for a few minutes.

---A short recess.

COMMISSIONER MACKINTOSH: Professor Lundberg, the matters we have been talking about undoubtedly contributed to a very helpful fiscal policy to go with your monetary policy. Were there any other elements in the fiscal policy of the government which you found particularly helpful in recent years?

PROFESSOR LUNDBERG: There were both unhelpful and helpful elements. That is the same in all countries. Part of our troubles are caused through what we call stabilization policies creating instabilities. There are theories and views on the general economic development in Western Europe during the post-war period, maintaining that those instabilities we have had are very much the effects of governments trying to create stability. That is an old theory, that presumed it was the bad monetary policy carried out, with increases of rate of interest at the last stage of the boom, contributing much to the crisis that came about. If in a recession you apply, as we have been applying, a very expansionary fiscal policy, creating a big budgetary deficit, having expanding public works and filling the banks with money, as a result of this fiscal policy you create trouble for the next boom period. You create difficulties for yourself in managing the boom that follows because of the liquidity created.

When you try to really manage the boom, as the English or American have done, by restrictive

fiscal policies or having effective built-in stabilizers at work, with the high progressive taxes, as we have in Sweden, that helps to stabilize the boom. Our economies are so integrated with each other's that it is very difficult to say to what extent the policies carried out are stabilizing or unstabilizing.

We think that the kind of fiscal policy we had during the years from the middle of the fifties was rather bad, creating problems. The steady government deficit created during the recession periods was making the monetary policy more difficult than it otherwise would have been. So, the fiscal policy had not been so well co-ordinated with monetary policy, as would have been desired.

On the other hand, I must say, of course, that the expansion of government expenditure during the recessions has helped to counteract the recessions. Also, some restriction of government expenditure during the boom period has also helped; but, in themain, I think that government fiscal policy has not been so effective, except for the investment tax up to the last few years.

But from 1960, with the introduction of the general sales tax, the government finances have come in order. The government has reached a situation of over-balancing the total budget for the first time in many years. That has given more

fiscal policies or having effective built-in stabilizers at work, with the high progressive taxes, as we have in Sweden, that helps to stabilize the boom. Our economists are [illegible] agreed [illegible] that it is very difficult to say to what extent the policies carried out are stabilizing or un-stabilizing.

We think that the kind of fiscal policy we had during the years from the middle of the fifties was rather bad, creating problems. The steady government deficit created during the recession periods was making the monetary policy more difficult than it otherwise would have been. So, the fiscal policy had not been so well co-ordinated with monetary policy, as would have been useful.

On the other hand, I must say, of course, that the expansion of government expenditure during the recessions has helped to counteract the recessions. Also, some restriction of government expenditure during the boom period has also helped; but in Sweden, I think that government fiscal policy has not been so effective, except for the investment tax up to the last few years.

But from 1960, with the introduction of the general sales tax, the government finances have come in order. The government has reached a situation of over-balancing the total budget for the first time in many years. That has given more

possibilities of managing also monetary policies. So I would say that the kind of general sales tax introduced from the beginning of 1960, and increased from the beginning of 1962, has been helpful in preventing the creation of liquidity and also in keeping down private consumption expenditure to a certain extent. There will be greater possibilities of having a coordination between monetary and fiscal policies by the government when the budget is brought into better balance in this way.

Another aspect of fiscal policy which I mentioned in my memo, and which I would like to mention now, is the introduction of the general pensions scheme which has changed the environment of monetary policy quite a lot. It is really a very ambitious kind of scheme. I disregard here the welfare element in the pensions system as such, for individuals, and look upon its financial aspect.

From this point of view the intention of combining a big pension reform with a big pension savings fund was that when you take away the incentive of saving to the private individual that is combined with looking at old age, and having private insurance taking care of the kind of building up of reserves that is necessarily combined when you arrange your pension in that way -- when taking that incentive away and introducing a general government scheme of generous insurance for the whole population, we were

afraid the system would fall down very much, and that insurance companies would have bad effects on savings. Therefore, the pensions reform was combined with the building up of a big pension fund. That is not at all necessary technically for arranging the pension reform. You can always take up premium payments high enough to cover the yearly expenses. But to balance the effect of falling away of private savings that pension fund was created.

I was a member of a committee under the chairmanship of the governor of the Riksbank to find ways and means and techniques of managing such a fund in order to make as little a disturbance in the working of our imperfect financial system as possible. We were afraid this fund would get such a tremendous grip over our capital market that it would be dangerous.

COMMISSIONER MACKINTOSH: Is the whole of the pension liability funded?

PROFESSOR LUNDBERG: No, just an arbitrary part of it. It has no acturial thinking behind it at all. It is just the part we thought sufficient for compensating potential loss in savings.

The order of size of the pension fund I could indicate by transforming it into Canadian conditions, and putting it into the comparative size of your Gross National Product in relation to our Gross National Product. At the end of

afraid the system would fall down very much, and that insurance companies would have bad effects on savings. Therefore, the pensions reform was combined with the building up of a big pension fund. That is not at all necessary technically for arranging the pension reform. You can always take up premium payments high enough to cover the yearly expenses. But to balance the effect of falling away of private savings that pension fund was created.

I was a member of a committee under the chairmanship of the governor of the Riksbank to find ways and means and techniques of managing such a fund in order to make as little a disturbance in the working of our imperfect financial system as possible. We were afraid this fund would get such a tremendous grip over our capital market that it would be dangerous.

COMMISSIONER MACKINTOSH: Is the whole of the pension liability funded?

PROFESSOR LUNDBERG: No, just an arbitrary part of it. It has no actuarial thinking behind it at all. It is just the part we thought sufficient for compensating potential loss in savings.

The order of size of the pension fund [illegible] conditions, and putting it into the comparative size of your Gross National Product in relation to our Gross National Product. At the end of

this decade the size of this pension fund will be about $15 billion (Canadian) that is related to your conditions. The yearly increase is so heavy that it really matters very much in the regular contributions to long term savings of the country.

Then, of course, it is a problem for a country of our size to manage this and not give the man in control of this fund too much power and influence over the whole economy. The technique employed was partly one of dividing into three funds, depending on the sources from which the premiums came. The other is that of having industrial corporations being given the right to borrow back part of the premiums they pay into the pension scheme on the wages that they pay out. So that now it is arranged so that every corporation paying pension premiums for their workers into the fund has the right to borrow back half of this for their own use at the market rate of interest. That is a way of decentralizing the effect of concentrating so much power in the fund. However, the private corporations have not been using this possibility to any great extent, but during credit squeezes they will be using it to a greater extent, I presume.

This way of dividing the fund into three parts has not worked out, because the whole technique of administering the funds is carried out by one manager and three employed people. It is an "easy" job, taking out sums of money and placing the money into security. They are not to do direct lending business, buying shares and stocks. They just place the money into government and industrial bonds, and long term obligations of that kind, and nothing else, except for re-lending to industry paying premiums.

The man doing this job is a very responsible person, and will have a lot to say about the kinds of yields that he will accept as satisfactory from the point of view of the Swedish pension takers in the future. We should include this in the fiscal policy measures in a very broad sense, it is part of it, because this means that we have a new supply coming in regularly, and a reliable one, on the long term market for bonds. That has shifted and changed our whole financial climate in Sweden rather drastically from the end of the fifties to the beginning of the sixties.

The combination of what I said about the finance minister being able to balance the budget by the new tax on consumption expenditure -- combined with the pension scheme and pension premiums paid into the fund, has meant both that the demand for capital funds has declined, because the government

This way of dividing the fund into three parts has not worked out, because the whole technique of administering the funds is carried out by one manager and three employed people. It is an "easy" job, taking out sums of money and placing the money into security. They are not to do direct lending business, buying shares and stocks. They just place the money into government and industrial bonds, and long term obligations of that kind, and nothing else, except for re-lending to industry paying premiums.

The man doing this job is a very responsible person, and will have a lot to say about the kinds of yields that he will accept as satisfactory from the point of view of the Swedish pension takers in the future. We should include this in the fiscal policy measures in a very broad sense, it is part of it, because this means that we have a new supply coming in regularly, and a reliable one, on the long term market for bonds. That has shifted and changed our whole financial climate in Sweden rather drastically from the end of the fifties to the beginning of the sixties.

The combination of what I said about the finance minister being able to balance the budget by the new tax on consumption expenditure -- combined with the pension scheme and pension premiums paid into the fund, has meant both that the demand for capital funds has declined, because the government

has not the deficit any more and at the same time that the supply has increased. The increase of the funds of the private insurance companies has not grown as rapidly as before, but surprisingly much, with the net result that there is a heavy increase in the supply of long-term funds for the Swedish economy. So, on the capital budget side there is a much better balance than we have ever had in the post-war period. This means it will be easier to carry on the monetary policy under these better balanced positions.

COMMISSIONER MACKINTOSH: All this has as a background your very satisfactory growth rate during this period. With a less satisfactory growth rate would you favour being pretty bold in deficit financing in the expansion of government expenditures, which you implied have been overdone in Sweden, in your circumstances?

PROFESSOR LUNDBERG: During the fifties?

COMMISSIONER MACKINTOSH: Yes.

PROFESSOR LUNDBERG: I would say it was a bad fiscal policy and before the growth of the Swedish economy we, most of the time, because of this, had excess demand for commodities and labour, and the difficulty created by surplus liquidity was very difficult to manage.

has not the deficit any more and at the same time that the supply has increased. The increase of the funds of the private insurance companies has not grown as rapidly as before, but surprisingly much, with the net result that there is a heavy increase in the supply of long-term funds for the Swedish economy. So, on the capital budget side there is a much better balance than we have ever had in the post-war period. This means it will be easier to carry on the monetary policy under these [illegible]

[illegible]

has as a background your very satisfactory growth rate during this period. With a less satisfactory growth rate would you favour being pretty bold in deficit financing in the expansion of government expenditures, which you implied have been overdone in Sweden, in your circumstances?

[illegible]

[illegible]

[illegible]

PROFESSOR LUNDBERG: I would say it was a bad fiscal policy and before the growth of the Swedish economy we, most of the time, because of this, had excess demand for commodities and labour, and the difficulty created by surplus liquidity was very difficult to manage.

You get some kinds of inefficiency out of the excess demand which we had during these periods. When entrepreneurs and corporations have excess demand for their products and workers have a very strong position in the firms, they all act in a relatively ineffective way. There must be a certain amount of pressure in order to make people manage their jobs with efficiency. We have had over-mobility of labour. You know you can have over-mobility of labour as well as too little mobility, and during those periods people were just leaving one job for another when they considered it better, and that created difficulties for management. Management had not the pressure on them of keeping down costs, under those inflated conditions in which the Swedish economy worked during part of this period. Now that had much to do with fiscal policy that was too expansive, from this point of view.

I think that after 1957, anyhow, as far as we can see, productivity has been increasing more rapidly than during the times before, and that has something to do with harder competition in the world markets, and also more competition on the Swedish market and less of excess demand.

But as I have put it in my memo, we are aware of the fact that very much of the increase

You get some kinds of inefficiency out of the excess demand which we had during these periods. [illegible] have excess demand for their products and workers have a very strong position in the firms, they all act in a relatively ineffective way. There must be a certain amount of pressure in order to [illegible] We have had over-mobility of labour. You know you can have over-mobility of labour as well as too little mobility, and during those periods people were just leaving one job for another when they considered it better, and that created difficulties for management. Management had not the pressure on them of keeping down costs, under those inflated conditions in which the Swedish economy worked during part of this period. Now that had much to do with fiscal policy that was too expansive, from this point of view.

I think that after 1957, anyhow, as far as we can see, productivity has been increasing more rapidly than during the times before, and that has something to do with harder competition in the world markets, and also more competition on the Swedish market and less of excess demand.

But as I have put it in my memo, we are aware of the fact that very much of the increase

of productivity in any country refers to the fact that you must shift resources all the time from stagnating branches of activity to the expanding ones. In order to do that you can get too much of excess demand, so even those sectors of the economy which should lose manpower have good times and the others have over-good times, and you get bad results. On the other hand, you can have such sluggish and low demand that even growth industries have difficulties so that they will not grow and, therefore, you have unemployment and sagging in the stagnating industries. There is an optimum in between where you have a certain amount of excess demand in growth industries, that you hope to satisfy by shifting your resources from the stagnating to the growing industries. That is what we hope to fulfil.

We know that the times to come will be more difficult, perhaps, than the times past, because the shifts of the European markets and over-capacity problems coming up mean that management and industry have to be aware of shifts in resource application more than perhaps during the fifties, and that puts great claims on a sensible economic policy.

COMMISSIONER MACKINTOSH: But you would, in periods of slack demand, favour deficit financing?

of productivity in any country refers to the fact that you must shift resources all the time from stagnating branches of activity to the expanding ones. In order to do that you can get too much of excess demand, so even those sectors of the economy which should lose manpower have good times and the others have over-good times, and you get bad results. On the other hand, you can have such sluggish and low demand that even growth industries have difficulties so that they will not grow and, therefore, you have unemployment and sagging in the stagnating industries. There is an optimum in between where you have a certain amount of excess demand in growth industries, that you hope to satisfy by shifting your resources from the stagnating to the growing industries. That is what we hope to fulfil.

We know that the times to come will be more difficult, perhaps, than the times past, because the shifts of the European markets and over-capacity problems coming up mean that management and industry have to be aware of shifts [illegible] the fifties, and that puts great claims on a sensible economic policy.

[illegible] in periods of slack demand, favour deficit financing?

PROFESSOR LUNDBERG: Yes, I have not much of inhibitions in that direction. There are limits even there, however. You might put so much money in circulation or have such excess demand that you create dis-confidence, and people will react badly. How they react depends very much on what they are accustomed to. Certain people react strongly to any kind of government deficit financing and pronounce dis-confidence in the fiscal policy and have such powerful positions that difficulties in carrying on an expansive policy will be created.

However, in Sweden we have not that kind of situation, really, so I think that when we meet the next recession, and especially after having had a time of government surpluses and orderly financing, it will be easier for the finance minister quickly to lower taxes or expand government expenditure, and thus enjoy the deficit as a stimulation to the economy, knowing it is just for the time being, without creating trouble. That is accepted as a policy measure.

Of course, as I have made reservations before, we might also experience troubles with an exchange crisis. So far I have not been able to explain to you why we have not had troubles. However, if I have an opportunity to come back here in ten years' time we might have "enjoyed", in the meantime, an exchange crisis that I may be able to explain, and therefore would be able to

PROFESSOR LUNDBERG: Yes, I have not much of inhibitions in that direction. There are limits even there, however. You might put so much money in circulation or have such excess demand that you create dis-confidence, and people will react badly. How they react depends very much on what they are accustomed to. Certain people react strongly to any kind of government deficit financing and pronounce dis-confidence in the fiscal policy and have such powerful positions that difficulties in carrying on an expansive policy will be created.

However, in Sweden we have not that kind of situation, really, so I think that when we meet the next recession, and especially after having had a time of government surpluses and orderly financing, it will be easier for the finance minister quickly to lower taxes or expand government expenditure, and thus enjoy the deficit as a stimulation to the economy, knowing it is just for the [illegible], without [illegible]. [illegible] is accepted as a policy measure.

Of course, as I have made reservations before, we might also experience troubles with an exchange crisis. So far I have not been able to explain to you why we have not had troubles. However, if I have an opportunity to come back here in ten years' time we might have "enjoyed", in the meantime, an exchange crisis that I may be able to explain, and therefore would be able to

throw more light on this question than I am able to do now. But we are quite open to the possibility that our expansive policy might be more limited just because of exchange difficulties in a future recession.

COMMISSIONER MACKINTOSH: I think this means the Swedes are not more inventive than Canadians in all fields.

PROFESSOR LUNDBERG: We have had lots of good luck. I think we have "chosen" a better structure for our economy than you have from this point of view. As I have said in this memorandum, we have not tried to protect all our industries, putting high tariffs on and getting secondary industries in all fields, but instead, letting the development occur under hard competition and letting the most enterprising and expanding firms work and fight on their own markets with competitors from abroad and squeezing the inefficient out of business. I think that explains why we have had greater possibility of fighting and not getting into troubles along those lines.

COMMISSIONER BROWN: On the pension scheme, did I understand you to say in your evidence when you were discussing it this morning that there was some method of compensating for the cost of living increase?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER BROWN: Could you describe that to us?

PROFESSOR LUNDBERG: Yes. It is very simple: the people now paying pension premiums have been promised pensions in future related in the real value terms. There is a consumption price index accepted as good evaluation of what the costs of living are and will be, and the pensions being paid out will not be paid out according to actual premiums and nominal values paid in now, but according

PROFESSOR LUNDBERG: We have had lots of good luck. I think we have "chosen" a better structure for our economy than you have from this point of view. As I have said in this memorandum, we have not tried to protect all our industries, putting high tariffs on and getting secondary industries in all fields, but instead, letting the development occur under hard competition and letting the most enterprising and expanding firms work and fight on their own markets with competitors from abroad and squeezing the inefficient out of business. I think that explains why we have had greater possibility of fighting and not getting into troubles along those lines.

COMMISSIONER BROWN: On the pension scheme, did I understand you to say in your evidence when you were discussing it this morning that there was some method of compensating for the cost of living increase?

PROFESSOR LUNDBERG: Yes.

COMMISSIONER BROWN: Could you describe that to us?

PROFESSOR LUNDBERG: Yes. It is very simple: the people now paying pension premiums have been promised pensions in future related in the real value terms. There is a consumption price index accepted as good evaluation of what the costs of living are and will be, and the pensions being paid out will not be paid out according to actual premiums and nominal values paid in now, but according

to the actual value of the money when they get the pensions. So, they pay and are promised pensions relating to the future level of wages for the living population at that time. It is a guarantee as to the standard of life in relation to the living population at that time. The philosophy behind this is simply that those people working now for the future of the Swedish economy are really investing and working and saving for the living generations that will support them in the future. They have done the job that makes the future standard of living what it will be when they are pensioners, and they should have a part of that standard of life. So, it is a very generous kind of scheme from that point of view. Looking backward I think the old system was a kind of cheating. When people had paid premiums from before the first World War and are getting nominal values according to the premiums paid at that time, that is really bad from equity point of view. However, the Swedish scheme might mean troubles also. It will mean as our population is aging that it will be a heavy burden on the future generation.

COMMISSIONER BROWN: Is this a pension that comes as a right or only to those who have contributed to it?

PROFESSOR LUNDBERG: There are lots of complicated transfer difficulties. With those people now paying who are over 50 years of age, they will not get the full pension, but they will get more in

to the actual value of the money when they get the pensions. So, they pay and are promised pensions relating to the future level of wages for the living population at that time. It is a guarantee as to the standard of life in relation to the living population at that time. The philosophy behind this is simply that those people working now for the future of the Swedish economy are really investing and working and saving for the living generations that will support them in the future. They have done the job that makes the future standard of living what it will be when they are pensioners, and they should have a part of that standard of life. So, it is a very generous kind of scheme from that point of view. Looking backward I think the old system was a kind of cheating. When people had paid premiums from before the First World War and are getting nominal values according to the premiums paid at that time, that is really bad from equity point of view. However, the Swedish scheme might mean troubles also. It will mean as our population is aging that it will be a heavy burden on the future generation.

COMMISSIONER BROWN: Is this a pension that comes as a right or only to those who have contributed to it?

PROFESSOR LUNDBERG: There are lots of [illegible] people now paying who are over 50 years of age, they will not get the full pension, but they will get more

relation to what they pay in premiums. They are over-compensated in relation to the premiums they have paid, but they will not get the pensions in relation to the people who will have been paying for 30 years. Every person in Sweden now is collecting pension points, and pension points are related to what kind of wages they have on a certain basis up to the amount of 30,000 crowns (in 1960 value of money) -- a little less than a professor's wage. So that, the pensions will be graduated in relation to the wages and salaries that people have been earning during their working time, up to a certain limit. There are possibilities for people in the higher wage groups who have pension arrangements to complement and add to their general pensions by private insurance companies, as usual, but that is outside this scheme. It has been the argument among the labour population in Sweden -- the socialists and trade union people -- that our society is a class society still, not in the least from the point of view that salaried people and people with higher wages had better payments and sickness allowances and pension rights, and the workers were very poorly endowed in that regard. Now, with this pension reform, they are very much in the same positions as the white collar workers; they have about the same pension rights as the salaried workers -- corresponding to about 60 per cent of wages during active life. That is a good standard of living and I think it is too ambitious, because the current cost of keeping alive when you are old, not having all

relation to what they pay in premiums. They are over-compensated in relation to the premiums they have paid, but they will not get the pensions in relation to the people who will have been paying for 30 years. Every person in Sweden now is collecting pension points, and pension points are related to what kind of wages they have on a certain basis up to the amount of 30,000 crowns (in 1960 value of money) -- a little less than a professor's wage. So that, the pensions will be graduated in relation to the wages and salaries that people have been earning during their working time, up to a certain limit. There are possibilities for people in the higher wage groups who have pension arrangements to complement and add to their general pensions by private insurance companies, as usual, but that is outside this scheme. It has been the argument among the labour population in Sweden -- the socialists and trade union people -- that our society is a class society still, not in the least from the point of view that salaried people and people with higher wages had better payments and sickness allowances and pension rights, and the workers were very poorly endowed in that regard. Now, with this pension reform, they are very much in the same positions as the white collar workers; they have about the same pension rights as the salaried workers -- corresponding to about 60 per cent of wages during active life. That is a good standard of living and I think it is too ambitious, because the current cost of keeping alive when you are old, not having all

family responsibilities, is much lower. It has been a heavy competitive pressure between political parties to take care of these possibilities. It is not only the socialists' fault that the reform has become very generous. The other parties have been as active in that regard in order to earn votes.

COMMISSIONER BROWN: This seems to be a world-wide phenomenon.

PROFESSOR LUNDBERG: Yes. The important side of this scheme is that it means that it is much easier for entrepreneurs to take on old workers and old salaried people without the heavy cost of their pensions when they take them. So, it also helps for mobility of labour. The pension right is independent of where you work -- this right of earning pension points. It follows you through life.

COMMISSIONER MACKINTOSH: I would like to ask you one or two things on a matter that you have already spoken of to some degree. To what extent is there need for in the Swedish economy a wages policy? How do you cope with the bargaining position of the workers and the increase in wages which is apt to result?

PROFESSOR LUNDBERG: It is a very great difference from the Dutch position, as you discussed, I think, yesterday, where they have a central board with some very strong powers, potentially, to regulate and determine the policy of the country. The Australians have compulsory arbitration and courts of that nature. We have nothing of that kind. Both the employers' unions and the trade unions fight against any

family responsibilities, is much lower. It has been a heavy competitive situation between political parties to take care of these possibilities. It is not only the socialists' fault that the reform has become very generous. The other parties have been as active in that regard in order to earn votes.

COMMISSIONER BROWN: This seems to be a world-wide phenomenon.

PROFESSOR LUNDBERG: [illegible] side of this scheme is that it means that it is much easier for entrepreneurs to take on old workers and old salaried people without the heavy cost of their pensions when they take them. So, it also helps for mobility of labour. The pension right is independent of where you work -- this right of earning pension points. It follows you through life.

COMMISSIONER MACKINTOSH: I would like to ask you one or two things on a matter that you have already spoken of to some degree. To what extent is there need for in the Swedish economy a wages policy? How do you cope with the bargaining position of the workers and the increase in wages which is apt to result?

PROFESSOR LUNDBERG: It is a very great difference from the Dutch position, as you discussed, I think, yesterday, where they have a central board with some very strong powers, potentially, to regulate and determine the policy of the country. The Australians have compulsory arbitration and courts of that nature. We have nothing of that kind. Both the employers' unions and the trade unions fight against ar

government interference into the wage determination of the country. They like to keep to their own ways of determining their wages and feel that the labour market should be free from government interference. There is a very strong belief in this from the trade union side as well as from the employers' side. They are completely united in this respect.

Our finance ministers have many times taken up the problem with the trade union leadership and said, "Now, you should be restrictive and not carry on that kind of wage policy and demand too much and too high wage increases in this situation. You are making it still more difficult for me as finance minister to carry out my duties in regulating the economy and trying to avoid inflation." The trade union leader has always answered, "It is not our job to concern ourselves with the value of money. That is your job as finance minister. We cannot in relation to our workers say that we have abstained from using the wage increase possibilities when the entrepreneurs have been willing to pay us more because of the high profits".

government interference into the wage determination of the country. They like to keep to their own ways of determining their wages and feel that the labour market should be free from government interference. There is a very strong belief in this from the trade union side as well as from the employers' side. They are completely united in this respect.

Our finance ministers have many times taken up the problem with the trade union leadership and said, "Now, you should be restrictive and not carry on that kind of wage policy and demand too much and too high wage increases in this situation. You are making it still more difficult for me as finance minister to carry out my duties in regulating the economy and trying to avoid inflation." The trade union leader has always answered, "It is not our job to concern ourselves with the value of money. That is your job as finance minister. We cannot in relation to our workers say that we have abstained from using the wage increase possibilities when the entrepreneurs have been willing to pay us more because of the high profits".

"We would be dismissed by our workers, and great dissatisfaction would arise if we took on the burden and the job of demanding less wage increases than we know can obtain out of the entrepreneurs' profits. So, please don't ask us this." So they say to the finance minister and the head of the Riksbank, "You must carry out your policies so that there will be no excess demand for labour, so that the entrepreneurs are not offering us too high wages and tempting us. It is your job to do this and we will see to it that the general wage level will be adapted to the kind of situation you are creating by the policy and that big wage differentials do not develop."

It was a different situation in 1951-1952 when the responsible trade union people demanded 20 per cent. They said, "The entrepreneurs are willing to pay, and you carry on a reckless finance policy so that we have to demand these wages. We are sorry for you, but what can we do about it?"

From this point of view, you might say that this is no wage policy at all, but I maintain that it is in a way. Our trade union leadership is very centralized. We do not have at all that kind of English, American or Canadian rivalry between the trade unions, and that makes the thing much easier. For the white collar workers the trade union is also centralized and very strong. They carry on wage negotiations for the coming year starting

"We would be dismissed by our workers, and great dissatisfaction would arise if we took on the burden and the job of demanding less wage increases than we know can obtain out of the entrepreneurs' society. [illegible] this." So they say to the finance minister and the head of the Riksbank, "You must carry out your policies so that there will be no excess demand for labour, so that the entrepreneurs are not offering us too high wages and tempting us. It is your job to do this and we will see to it that the general wage level will be adapted to the kind of situation you are creating by the policy and that big wage differentials do not develop."

It was a different situation in 1951-1952 when the responsible trade union people demanded 20 per cent. They said, "The entrepreneurs are willing to pay, and you carry on a reckless finance policy so that we have to demand these wages. We are sorry for you, but what can we do about it?"

From this point of view, you might say that this is no wage policy at all, but I maintain that it is in a way. Our trade union leadership is very centralized. We do not have at all that kind of English, American or Canadian rivalry between the trade unions, and that makes the thing much easier. For the white collar workers the trade union is also centralized and very strong. They carry on wage negotiations for the coming year starting

in November and concluding in about March. They make something like a central wage directive to the different trade unions all over the country, and they try to find out what the employers will pay, what the workers are demanding, and what the pressures are, and they fill all this out with a tremendous amount of negotiation and research. From this comes a general crystallization of 4 per cent of 5 per cent general wage increase with some kind of differential according to the different branches of activity that seems reasonable in order to repair some unacceptable differentials that have appeared in the last few years. When the trade unions work out the differentials in the factories they follow the central recommendations very closely.

All this means there is not a wage policy from the Dutch point of view at all. It is a market policy where the trade unions and employers' unions fight very vigorously with the menace of lockouts and strikes in the background. However, we have not had a strike since 1945 of any considerable size. There have been very few hours lost -- some few, but very little of it.

We have a labour court which is very effective in seeing to it that no collective agreements break down during the time of the agreement. That never happens in Sweden, because of the acceptance of the judgment of the court. There must, of course, be some menace of something in the background such as a lockout or a general strike. So that the policy is

in November and concluding in about March. They make something like a central wage directive to the different trade unions all over the country, and they try to find out what the employers will pay, what the workers are demanding, and what the pressures are, and they fill all this out with a tremendous amount of negotiation and research. From this comes a general crystallization of 4 per cent or 5 per cent general wage increase with some kind of differential according to the different branches of activity that seems reasonable in order to repair some unacceptable differentials that have appeared in the last few years. When the trade unions work out the differentials in the factories they follow the central recommendations very closely.

All this means there is not a wage policy from the Dutch point of view at all. It is a market policy where the trade unions and employers' unions fight very vigorously with the menace of lockouts and strikes in the background. However, we have not had a strike since 1945 of any considerable size. There have been very few hours lost -- some few, but very little of it.

We have a labour court which is very effecti in seeing to it that no collective agreements break down during the time of the agreement. That never happens in Sweden, because of the acceptance of the judgment of the court. There must, of course, be some menace of something in the background such as a lockout or a general strike. So that the policy is

that the employers'unions and trade unions try to work out what is tolerable and what is acceptable. The policy means that they try to adjust wage changes according to the developments in the different sectors of the economy. They would see to it that the entrepreneurs in a particular activity, whether it is one with low profits and no active trade, that there will be lower wages or keep down the wage increases too much. There may be a certain tolerance, but not too much, and that will be quickly taken back another year.

It is, as I have said, a central wage policy from the point of view that it is big organizations to bargain and fight out the general development of wages, but it is not a government policy. They can only indirectly influence the situation by the type of economic situation, and demand for goods and labour that is created by policy.

The difficulty with this kind of wage policy is that we have so much piece rate wages, and this means when new machines are introduced, new deals and wage bargaining always continuously happen. There is the wage slide when there is a high demand for labour. So, if you look at it in the general development of Swedish wages, you will find half of the wage increases over time are explained by what we call wage slides; that is, outside collective agreements. These wage slides will be determined and will fluctuate over the business cycle,

that the employers' unions and trade unions try to work out what is tolerable and what is acceptable. The policy means that they try to adjust wage changes according to the developments in the different sectors of the economy. They would see to it that the entrepreneurs in a particular activity, whether it is one with low profits and no active trade, that there will be lower wages or keep down the wage increases too much. There may be a certain tolerance, but not too much, and that will be quickly taken back [illegible].

It is, as I have said, a central wage policy from the point of view that it is big organizations to bargain and fight out the general development of wages, but it is not a government policy. They can only indirectly influence the situation by the type of economic situation, and demand for goods and labour that is created by policy.

The difficulty with this kind of wage policy is that we have so much piece rate wages, and this means when new machines are introduced, new deals and wage bargaining always continuously happen. There is the wage slide when there is a high demand for labour. So, if you look at it in the general development of Swedish wages, you will find half of the wage increases over time are explained by what we call wage slides; that is, outside collective agreements. These wage slides will be determined and will fluctuate over the business cycle,

so that if there are boom times wage slides will be higher, and much lower during recessionary times. Each year or each second year when there are general collective bargainings account will be taken of what has happened on the wage front with these slides so that unjust differentials can be removed. I do not know if I can make myself clear. Books have been written about this, and I cannot explain all this in just a short speech.

COMMISSIONER MACKINTOSH: That is very clear. I gather from what you said earlier that an essential element in thisprocess is a pretty strong and pretty sophisticated bureaucracy in the labour movement so that they are extremely well informed?

PROFESSOR LUNDBERG: One interesting feature of the trade union movement is that they like private enterprise. They don't like socialist and government enterprise because it is no fun to fight them. It is very easy to be government controlled if it is a government enterprise. The union people are very strong in holding on to a very big private sector in the economy to enjoy this fight with private entrepreneurs and squeeze profits out of them. You will notice among trade union people that their attitudes are very strong for free trade, free enterprise, free collective bargainings, and mobility of labour, and they are very strong advocates of competition from abroad. Also, a strong hold for private enterprise in Sweden is taken by our co-operative societies; they play a very great role in

so that if there are boom times wage slides will be higher, and much lower during recessionary times. Each year or each second year when there are general collective bargainings account will be taken of what has happened on the wage front with these slides so that unjust differentials can be removed. I do not know if I can [illegible] this, and I cannot explain all this in just a short speech.

COMMISSIONER MACKINTOSH: That is very clear. I gather from what you said earlier that an essential element in thisprocess is a pretty strong and pretty sophisticated bureaucracy in the labour movement so that they are extremely well informed?

PROFESSOR LINDBERG: One interesting feature of the trade union movement is that they like private enterprise. They don't like socialist and [illegible] them. It is very easy to be government controlled if it is a government enterprise. The union people are very strong in holding on to a very big private sector in the economy to enjoy this fight with private entrepreneurs and squeeze profits out of them. You will notice among trade union people that their attitudes are very strong for free trade, free enterprise, free collective bargainings, and mobility of labour, and they are very strong advocates of competition from abroad. Also, a strong hold for private enterprise in Sweden is taken by our co-operative societies; they play a very great role in

Sweden. A large sector of retail trade and also a large sector of production is carried on by a very big co-operative control movement. Although many of the leaders are socialist and trade union leaders, they also "love" private enterprise because they like to compete with them. They like to show they are more effective, and they are very strong pleaders for avoiding measures that would put difficulties in the working of competition in the Swedish economy. The private people, especially in retail, often do not understand what a strong defence for private enterprise these co-operative movements, as well as the trade unions, really are against people who would like to go on with more interfering and more socialistic measures than our socialistic government is actually carrying out.

THE CHAIRMAN: I wish to thank you very much indeed, Professor Lundberg. We have had a most interesting day. Your comments and the information that you have provided have been very helpful to our deliberations.

PROFESSOR LUNDBERG: Thank you. I have enjoyed these sittings very much, and I hope I have succeeded in making myself understood.

THE CHAIRMAN: We will adjourn now until 9:15 tomorrow morning.

---Adjournment.

Sweden. A large sector of [illegible] and also a large sector of [illegible] big co-operative [illegible] movements. Although many of the leaders are socialist and trade union leaders, they also "love" private enterprise because they like to compete with them. They like to show they are more effective, and they are very strong pleaders for avoiding measures that would put difficulties in the working of competition in the Swedish economy. The private people, especially in retail, often do not understand what a strong defence for private enterprise these co-operative movements, as well as the trade unions, really are against people who would like to go on with more interfering and more socialistic measures than our socialistic government is actually carrying out.

THE CHAIRMAN: I wish to thank you very much indeed, Professor Lundberg. We have had a most interesting day. Your comments and the information that you have provided have been very helpful to our deliberations.

[illegible] enjoyed these sittings very much, and I hope I have succeeded in making myself understood.

THE CHAIRMAN: We will adjourn now until [illegible]

---Adjournment.

Royal Commission on Banking and Finance

MR.ERIK LUNDBERG

Hearings held at

OTTAWA

Vol. 29A

Date. SEPT. 12, 1962

Official Reporters
F.J. Nethercut and R.J. Young
Toronto, Ont.

MEMORANDUM FROM MR. ERIK LUNDBERG

TO THE

ROYAL COMMISSION ON BANKING AND FINANCE

RE

PROBLEMS OF STABILIZATION
POLICY IN SWEDEN AND CANADA

Stockholm,
August 13, 1962.

PROBLEMS OF STABILIZATION POLICY IN SWEDEN AND CANADA

In this memorandum I have tried to give an account of stabilization policy experiences in Sweden during the last decade that might be of interest from Canadian viewpoints. In order to avoid the danger of easy generalizations from Swedish experiences, I have presented a short account of some similarities and differences between Canadian and Swedish economic structure and economic problems. It is clear to me that much of the political milieu, the financial structure, the credit institutions a.s.o. are so different between Canada and Sweden that no easy and mechanical transfer of knowledge can be made. On the other hand also, the differences in attitudes and methods of approach may be stimulating for a discussion of policy problems. I hope that it is clear from the text that I am quite critical of various parts of Swedish economic policy, although I naturally try to put special emphasis on the policy achievements in Sweden that seem most interesting from a positive point of view. My very tentative recommendations as to the approach to some Canadian stabilization problems are made in a humble consciousness of well-balanced ignorance of political economies in Canada. They are just put down as a reaction to the Canadian problems from the point of view of the policy attitudes in Sweden and are presented here in order to give emphasis to important differences in both policy problems and policy attitudes.

1. Some similarities and differences in Economic Structure.

When comparing Canada and Sweden, there are

PROBLEMS OF STABILIZATION POLICY IN SWEDEN AND CANADA

In this memorandum I have tried to give an account of stabilization policy experiences in Sweden during the last decade that might be of interest from Canadian viewpoints. In order to avoid the danger of easy generalizations from Swedish experiences, I have presented a short account of some similarities and differences between Canadian and Swedish economic structure and economic problems. It is clear to me that much of the political milieu, the financial structure, the credit institutions a.s.o. are so different between Canada and Sweden that no easy and mechanical transfer of knowledge can be made. On the other hand also, the differences in attitudes and methods of approach may be stimulating for a discussion of policy problems. I hope that it is clear from the text that I am quite critical of various parts of Swedish economic policy, although I naturally try to put special emphasis on the policy achievements in Sweden that seem most interesting from a positive point of view. My very tentative recommendations as to the approach to some Canadian stabilization problems are made in a humble consciousness of well-balanced ignorance of political economies in Canada. They are just put down as a reaction to the Canadian problems from the point of view of the policy attitudes in Sweden and are presented here in order to give emphasis to important differences in both policy problems and policy attitudes

1. Some similarities and differences in Economic Structure

When comparing Canada and Sweden, there are

certain common features of economic structure and similarities as to policy problems. From this point of view, it is of interest to compare the growth and stability experiences of the two economies. There are, however, at the same time, interesting dissimilarities in the experiences of the two countries from which some useful knowledge may also be extracted.

Let me first mention some common features as to economic structure: We have in the main to do with free enterprise economies - referring to industry, trade, agriculture, banking and the rest of the financial system. Both countries have relatively high national income per capita and high dependence on foreign trade (exports being around 20 per cent of gross national income). Exports depend in both countries to a large extent on internal raw material resources (from mines and forests). Both countries are highly industrialized. The gross investment ratios are of the same order, of size although higher in Canada up to the middle of 1950's; around 1960 Sweden seems to have the higher ratio. There are relatively large Government sectors in the two countries. Both countries have similar positions vis à vis "super-neighbours" in the South (USA and EEC respectively) as most important trading partners.

There are also fundamental similarities as to targets of economic policy: Full employment, stability of the price level, equilibrium in balance of payments, stable and rapid economic growth. Also, the methods of policy are in a general way the same,

certain common features of economic structure and similarities as to [illegible]. From this point of view, it is of interest to compare the growth and stability experiences of the two economies. There are, however, at the same time, interesting dissimilarities in the experiences of the two countries from which some useful knowledge may also be extracted.

Let me first mention some common features as to economic structure: We have in the main to do with free enterprise economies - referring to industry, trade, agriculture, banking and the rest of the financial system. Both countries have relatively high national income per capita and high dependence on foreign trade (exports being around 20 per cent of gross national income). Exports depend in both countries to a large extent on internal raw material resources (from mines and forests). Both countries are highly industrialized. The gross investment ratios are of the same order, of size although higher in Canada up to the middle of 1950's: around 1960 Sweden seems to have the higher ratio. There are relatively large Government sectors in the two countries. Both countries have similar positions vis á vis "super-neighbours" in the South (USA and [illegible] respectively) as [illegible] trading partners.

There are also fundamental similarities as to targets of economic policy: Full employment, stability of the price level, equilibrium in balance of payments, stable and rapid economic growth. Also, the methods of policy are in a general way the same,

with reliance on a mixture of monetary and fiscal policies for reaching the stabilization targets.

Let me now mention some dissimilarities. Canada is relying on a considerable amount of capital imports from USA. Sweden has not had sustained long-term capital imports since before the first World War and had even sizable capital export during the inter-war period. During the post-war period, long-term capital imports and exports have played no role in Swedish economic development. This means that the gross savings in relation to national income coming from internal sources seem to have been higher in Sweden. Sweden, therefore, misses the type of complication in policy problems that arises out of high dependence on capital imports from a dominating power like USA.

Sweden's exports have a more happy composition (from a stabilization and growth point of view) than Canada's. The raw material component of iron ore, wood products and agricultural products is lower. Instead, in Swedish exports, such products as high quality steel, ships and especially engineering products take a large and rapidly growing part. The result is also that Sweden's export volume has been increasing nearly three times as rapidly in relation to real GNP as Canada's.

Population and labour force developments are very different. Canada has about the highest birth rate of the industrialized nations, Sweden the

with reliance on a mixture of monetary and fiscal policies for reaching the stabilization targets.

Let me now mention some dissimilarities. Canada is relying on a considerable amount of capital imports from USA. Swedea has not had sustained long-term capital imports since before the first world war and had even sizable capital export during the inter-war period. During the post-war period, long-term capital imports and exports have played no role in Swedish economic development. This means that the gross savings in relation to national income coming from internal sources seem to have been higher in Sweden. Sweden, therefore, misses the type of complication in policy problems that arises out of high dependence on capital imports from a dominating power like USA.

Sweden's exports have a more happy composition (from a stabilization and growth point of view) than Canada's. The raw material component of iron ore, wood products and agricultural products is lower. Instead, in Swedish exports, such products as high quality steel, ships and especially engineering products take a large and rapidly growing part. The result is also that Sweden's export volume has been increasing nearly three times as rapidly in relation to real GNP as Canada's.

Population and labour force developments are very different. Canada has about the highest birth rate of the industrialized nations, Sweden the

lowest. Also, because of a much higher rate of immigration, the Canadian labour force has been increasing much more rapidly than the employed population in Sweden.

Canada is a relatively protectionist country; Sweden has about the lowest tariffs of all countries in the world. Here there is an important difference in attitudes determined by historic traditions, economic structure and development conditions. The Swedish outlook is determined by a strong general belief in vigorous foreign competition as a necessary condition for efficiency in industry as well as for effective price competition. This attitude is, (as a principle), common to both labour and employer groups. There is no belief in labour (or socialist) circles that socialized corporations under planning work more effectively than private industry under competition. It is hardly necessary to mention the more fundamental difference that Sweden geographically is a very small country in relation to Canada (about 5 per cent of the surface area). This creates a difference in handling regional problems. In Sweden, an <u>active labour market policy</u> is one of the new important parts of economic policy and this implies, among other things, various measures to create higher labour mobility between jobs, branches of activity and regions of the country. It must be easier to create a satisfactory regional mobility in a country like Sweden than in Canada.

lowest. Also, because of a much higher rate of immigration, the Canadian labour force has been increasing much more rapidly than the employed population in Sweden.

Canada is a relatively protectionist country; Sweden has about the lowest tariffs of all countries in the world. Here there is an important difference in attitudes determined by historic traditions, economic structure and development conditions. The Swedish outlook is determined by a strong general belief in vigorous foreign competition as a necessary condition for efficiency in industry as well as for effective price competition. This attitude is, (as a principle), common to both labour and employer groups. There is no belief in labour (or socialist) circles that socialized corporations under planning work more effectively than private industry under competition. It is hardly necessary to mention the more fundamental difference that Sweden geographically is a very small country in relation to Canada (about 5 per cent of the surface area). This creates a difference in handling regional problems. In Sweden, an active labour market policy is one of the new important parts of economic policy and this implies, among other things, various measures to create higher labour mobility between jobs, branches of activity and regions of the country. It must be easier to create a satisfactory regional mobility in a country like Sweden than in Canada.

2. <u>Economic policy problems</u>.

Although the main targets are the same, the policy problems have a different accent in the two countries, partly because of varying kinds and degrees of deviation from the goals. Sweden has had more trouble with inflation than Canada, the rise in the cost of living index being in average about 4 per cent per year over the whole post-war period. The problem of a too rapid increase of wage costs is a burning issue in Sweden - not least from the point of view that Sweden has a relatively high wage-cost level (in relation to all Western Europe competitors). It is also apparent that excess demand problems have been much more in focus than in Canada.

On the other hand, Canada has had relatively more trouble with the stability of growth than Sweden. Sweden has had less of business cycle recessions of production and employment than Canada - although Sweden also had unemployment and stabilization problems in 1952-53 and 1958-59 that had to be taken seriously. Sweden has had no experience of a longer stagnation period, with none or very little growth of national income per capita, as in Canada over the years 1957-61. Sweden's economic process has been relatively stable over the whole post-war period, with a somewhat lower rate than Canada's; but on a per capita basis, Sweden seems to have had a more rapid rate of growth. In fact, there has been relatively little discussion in Sweden about insufficient growth in comparison with other countries.

Although the main targets are the same, the policy problems have a different accent in the two countries, partly because of varying kinds and degrees of deviation from the goals. Swedeh has had more trouble with inflation than Canada, the rise in the cost of living index being in average about 4 per cent per year over the whole post-war period. The problem of a too rapid increase of wage costs is a burning issue in Sweden - not least from the point of view that Sweden has a relatively high wage-cost level (in relation to all Western Europe competitors). It is also apparent that excess demand problems have been much more in focus than in Canada.

On the other hand, Canada has had relatively more trouble with the stability of growth than Sweden. Sweden has had less of business cycle recessions of production and employment than Canada - although Sweden also had unemployment and stabilization problems in 1952-53 and 1958-59 that had to be taken seriously. Sweden has had no experience of a longer stagnation period, with none or very little growth of national income per capita, as in Canada over the years 1957-61. Sweden's economic process has been relatively stable over the whole post-war period, with a somewhat lower rate than Canada's; but on a per capita basis, Sweden seems to have had a more rapid rate of growth. In fact, there has been relatively little discussion in Sweden about insufficient growth in comparison with other countries.

The fact that real GNP has grown more slowly during the post-war period in Sweden than in some other countries in Western Europe (as Germany, France and Italy) has been taken with great calm. The starting level of the post-war expansion has been high in Sweden (as well as in Canada and USA) compared with most other European countries. If a longer-term growth rate (reckoned for instance from the 1930's) is considered, Sweden ranks with the highest among comparable countries.

The balance of payments problems seem to have been more disturbing in Canada than in Sweden. As mentioned above, Canada's dependence on capital imports and the composition of Canada's exports (with a slower growth rate) must imply greater risks for exchange disturbances. The rapidly expanding markets of especially Swedish engineering products has implied good "space for internal expansion" without narrow balance of payments restrictions. Only in the year 1947 (after an appreciation of the Swedish Crown), did the Swedish Government succeed in creating an exchange crisis. In a way, it has been a continuing surprise to many economists that since then - with rather complete import liberalization and full convertibility (except for capital movements) - the Swedish payments position has been kept in equilibrium (with slowly rising exchange reserves) in spite of heavy demand pressure inside the country and an average rise of wages per hour of about 7 per cent per year.

I think it is important to observe that the above account of policy problems seems to imply that the Swedish problems have been and are "easier to handle" than the Canadian ones. Efficiency of stabilization policy must of course be measured with regard to the difficulties involved, i.e., to the potential deviations from the targets that tend to arise.

3. Differences in policy attitudes.

It is interesting to notice some rather fundamental differences as to policy attitudes. The Swedish Socialist Government has relatively few inhibitions with regard to interference in financial markets with its policy instruments. There is a propensity to experiment with new devices in order to keep full employment or to dampen down an inflationary boom. In Canada, there seems to be more of conservatism in this regard. The Canadian Government seems to have more with respect to the effective functioning of credit and financial markets; these should, if possible, not be disturbed with policy measures that could create undesired anticipations. The Swedish Government and Central Bank show rather little concern in this direction.

However, such a difference in attitudes as discussed above is not general. In other respects there may be contrary positions. I mentioned above the attitudes to protection and foreign competition on the home market. An important aspect of this issue is the Swedish attitude to the functioning of the labour market. Also, in this respect, there may be a difference from

I think it is important to observe that the above account of policy problems seems to imply that the Swedish problems have been and are "easier to handle" than the Canadian ones. Efficiency of stabilization policy must of course be measured with regard to the difficulties involved, i.e., to the potential deviations from the targets that tend to arise

[illegible]. Differences in policy attitudes.

It is interesting to notice some rather fundamental differences as to policy attitudes. The Swedish Socialist Government has relatively few inhibitions with regard to interference in financial markets with its policy instruments. There is a propensity to experiment with new devices in order to keep full employment or to dampen down an inflationary boom. In Canada, there seems to be more of conservatism in this regard. The Canadian Government seems to have more with respect to the effective functioning of credit and financial markets; these should, if possible, not be disturbed with policy measures that could create undesired anticipations. The Swedish Government and Central Bank show rather little concern in this directi

However, such a difference in attitudes as discussed above is not general. In other respects there may be contrary positions. I mentioned above the attitudes to protection and foreign competition on the home market. An important aspect of this issue is the Swedish attitude to the functioning of the labour marke

Also, in this respect, there may be a difference from

the Canadian approach. In Sweden, the policy issue is how to make the labour market function more effectively along the pattern of a free market. High mobility of labour between skills, jobs, branches of activity and regions are taken as prerequisites of an effective functioning. Effects in these directions are sought by means of a system of well informed labour exchanges, their activities including payments to workers for moving and for training to new jobs. A Government sponsored general pension scheme implies that there is no extra cost in taking on older workers. Efficient functioning of the labour market depends very much on how close to equilibrium of demand and supply the labour market is. Big excess or deficit demand conditions will tend to cause bad use and allocation of labour resources. A characteristic feature of the Swedish labour market during the post-war period is a considerable scarcity of workers (with many vacancies) within the rapidly growing sectors of the economy. This situation has implied relatively frictionless absorption of unemployment coming from agriculture and textile industry, so that the general unemployment rate has never surpassed 4 per cent. A conscious wage policy is also part of this scheme, aiming at economically justified wage relations. This means for instance that industries and firms with low productivity should not be subsidized by having relatively cheap labour. The underlying theory is that productivity-raising changes in the structure of the Swedish economy will be accelerated if labour, by being about as expensive as

the Canadian approach. In Sweden, the policy issue is how to make the labour market function more effectively along the pattern of a free market. High mobility of labour between skills, jobs, branches of activity and regions are taken as prerequisites of an effective functioning. Effects in these directions are sought by means of a system of well informed labour exchanges, their activities including [illegible] moving and for training to new jobs. A Government sponsored general pension scheme implies that there is no extra cost in taking on older workers. Efficient functioning of the labour market depends very much on how close to equilibrium of demand and supply the labour market is. Big excess or deficit demand condition will tend to cause bad use and allocation of labour resources. A characteristic feature of the Swedish labour market during the post-war period is a considerable scarcity of workers (with many vacancies) within the rapidly growing sectors of the economy. This situation has implied relatively frictionless absorption of unemployment coming from agriculture and textile industry, so that the general unemployment rate has never surpassed 4 per cent. A conscious wage policy is also part of this scheme, aiming at economically justified wage relations. This means for instance that industries and firms with low productivity should not be subsidized by having relatively cheap labour. The underlying theory is that productivity-raising changes in the structure of the Swedish economy will be accelerated if labour, by being about as expensive as

in the growth industries, is quickly squeezed out of firms and branches with low efficiency and by means of an active labour exchange policy, transferred to expanding fields of activity. It is this type of philosophy that is underlying the active labour market policy carried out in Sweden, certainly with a considerable lack of perfection in various respects. It is important to remember this philosophy as a background when discussing the monetary and fiscal stabilization measures applied during the post-war period.

4. Policy instruments used in Sweden.

It may be convenient at this point to describe the main monetary and fiscal policy instruments applied during the last ten years in Sweden. It is natural to start with policies carried out in order to dampen excess demand (inflationary boom) conditions that Sweden experienced during the periods 1955-57 and 1960-61. In both cases, one of the main difficulties of restrictive policy came from the fact that large budget deficits had created excess liquidity in the private sector and especially within the banking system. There was, however, a fundamental difference between the two periods in the method of dealing with the inflationary forces emanating from excess liquidity. In the first period, the main approach was to neutralize the liquid funds that flowed to the banking system and to the corporations as a result of financing large Government budget deficits by monetary expansion. During the second boom period, the monetary authorities aimed instead at absorbing and

in the growth industries, is quickly squeezed out of firms and branches with low efficiency and by means of an active labour exchange policy, transferred to expanding fields of activity. It is this type of philosophy that is underlying the active labour market policy carried out in Sweden, certainly with a considerable lack of perfection in various respects. It is important to remember this philosophy as a background when discussing the monetary and fiscal stabilization measures applied during the post-war period.

4. Policy instruments used in Sweden.

It may be convenient at this point to describ the main monetary and fiscal policy instruments applied during the last ten years in Sweden. It is natural to start with policies carried out in order to dampen excess demand (inflationary boom) conditions that Sweden experienced during the periods 1955-57 and 1960-6 In both cases, one of the main difficulties of restricti policy came from the fact that large budget deficits ha created excess liquidity in the private sector and especially within the banking system. There was, however, a fundamental difference between the two perio in the method of dealing with the inflationary forces emanating from excess liquidity. In the first period, the main approach was to neutralize the liquid funds that flowed to the banking system and to the corporatio as a result of financing large Government budget deficit by monetary expansion. During the second boom period,

[illegible]

mopping up the surplus liquidity that had been created.

A combination of monetary and fiscal policy measures were tried out from the beginning of 1955, when a pronounced investment boom was on the way in the private sector of the economy. An investment tax was introduced from the beginning of the year. A levy of 12 per cent on actual expenditures (above a certain minimum) for machinery and building (not dwellings) had to be paid. This type of measure had been used temporarily at earlier occasions. The important point was that this extra investment cost should not be regarded as being of permanent nature. In that case, there was apparently a great risk that the investment tax would behave as an extra cost-push factor and thereby be built into the price system. In actual fact, the tax seems to have had a strong postponement effect, stimulating corporations to wait whenever possible with their less urgent investment expenditures.

The level of interest rates was increased by about 1 per cent in the spring of 1955 at the same time as the requirements on liquidity ratios of the banks were raised. These measures were enforced by regulating bank advances, prescribing certain ceilings. This type of credit regulations was complemented by a more permanent Central Bank control of bond issues - referring to communes as well as private corporations. All these measures evidently implied severe regulations of the credit and capital markets and strong elements of credit rationing. The credit restrictions were mainly

mopping up the surplus liquidity that had been created.

A combination of monetary and fiscal policy measures were tried out from the beginning of 1955, when a pronounced investment boom was on the way in the private sector of the economy. An investment tax was introduced from the beginning of the year. A levy of 12 per cent on actual expenditures (above a certain minimum) for machinery and building (not dwellings) had to be paid. This type of measure had been used temporarily at earlier occasions. The important point was that this extra investment cost should not be regarded as being of permanent nature. In that case, there was apparently a great risk that the investment tax would behave as an extra cost-push factor and thereb be built into the price system. In actual fact, the tax seems to have had a strong postponement effect, stimulat ing corporations to wait whenever possible with their [illegible]

The level of interest rates was increased by about 1 per cent in the spring of 1955 at the same time as the requirements on liquidity ratios of the banks were raised. These measures were enforced by regulatin [illegible] This type of credit regulations was complemented by a more perman Central Bank control of bond issues - referring to communes as well as private corporations. All these measures evidently implied severe regulations of the credit and capital markets and strong elements of credit rationing. The credit restrictions were mainly

directed towards the commercial banks but the measures were complemented by looser agreements with savings banks and insurance companies with regard to their investment policies.

One typical Swedish feature of this regulation of the credit markets is that the liquidity requirements and ceilings on advances were founded on "voluntary" agreements between the Central Bank and the financial institutions. As a necessary background condition for reaching such agreements, there is a law for regulating liquidity quotas. This law was not enforced, however, as the banks preferred to accept this more flexible method of voluntary agreements, or recommendations from the side of the Riksbank.

It should be observed that "liquidity" ratios recommended to the commercial banks have a wider content than the corresponding Canadian concept. It includes long-term Government bonds as well as bonds issued by Government mortgage institutions. It is clear from this wide concept of "liquidity" that the Swedish type of restrictive credit policy is combined with important elements of Government direction of saving funds for special high priority uses. (Government and house building financing).

There is no doubt that the combination of monetary and fiscal policy measures (including a rise in corporation taxes) had considerable dampening effects on the investment boom of 1955-57. In fact the total

[illegible]

[illegible] banks and insurance companies with regard to their [illegible]

One typical Swedish feature of this regulation of the credit markets is that the liquidity requirements and ceilings on advances were founded on "voluntary" agreements between the Central Bank and the financial institutions. [illegible] reaching such agreements, there is a law for regulating liquidity quotas. This law was not enforced, however, as the banks preferred to accept this more flexible method of voluntary agreements, or recommendations from the side of the Riksbank.

It should be observed that "liquidity" ratios recommended to the commercial banks have a wider content than the corresponding Canadian concept. It includes long-term Government bonds as well as bonds issued by Government mortgage institutions. It is clear from this wide concept of "liquidity" that the Swedish type of restrictive credit policy is combined with important elements of Government direction of saving funds for special high priority uses. (Government and house [illegible])

There is no doubt that the combination of monetary and fiscal policy measures (including a rise [illegible]) on the investment boom of 1955-57. In fact the total

stock of loans and advances of the banking system to industry and trade kept nearly constant during the three years - a quite remarkable feature during a period with very profitable investment opportunities. The volume of investment in private industry also kept stable around the 1954 level. According to extensive interview studies carried out during 1955 and 1956, actual investment expenditures had been reduced by about 15 per cent below the plans existing at the end of 1954. This restrictive effect could be explained both by the investment fee and by the credit rationing, while the rise in the level of interest naturally played a minor role.

This achievement of effectively dampening investment activity during an international boom is especially remarkable when looking at the boom in private investment that came about in Sweden during the recession of 1958-59. During these years, investment in industry increased by 10-15 per cent per year - and had in 1961 reached about 60 per cent above the 1957 level. This anti-cyclical development must, to a large extent, be attributed to the quick relaxation of policy restrictions that was carried out from the beginning of 1958. The investment tax was abolished, the level of interest rates lowered and credit restrictions abolished (except for the issue control). The investment projects that had been postponed and accumulated during the boom years apparently could now more easily and cheaply be financed. This policy, that created a partial inversion

stock of loans and advances of the banking system to industry and trade kept nearly constant during the three years - a quite remarkable feature during a period with very profitable investment opportunities. The volume of investment in private industry also kept stable around the 1954 level. According to extensive interview studies [illegible] expenditures had been reduced by about 15 per cent below the plans existing at the end of 1954. This restrictive effect could be explained both by the investment fee and by the credit rationing, while the rise in the level of interest naturally played a minor role.

This achievement of effectively dampening investment activity during an international boom is especially remarkable when looking at the boom in private investment that came about in Sweden during the recession of 1958-59. During these years, investment in industry increased by 10-15 per cent per year - and had in 1961 reached about 60 per cent above the 1957 level. This anti-cyclical development must, to a large extent, be attributed to the quick relaxation of policy restrictions that was carried out from the beginning of 1958. The investment tax was abolished, the level of interest rates lowered and credit restrictions abolished (except for the issue control). The investment projects that had been postponed and accumulated during the boom years apparently could now more easily and cheaply be financed. This policy, that created a partial inversion

of the investment cycle, also ought to have had good effects on the profitability of investments; costs were lower, building materials and labour more easily available during 1958-59 than if the investments had been made during the boom years of general excess demand. One necessary condition for this relative success with the stabilization policy during these years was of course that the longer-term prospects of industry seemed promising. That was apparently the case. Expanding public works (with large Government budget deficits) and housebuilding during 1958-1959 contributed to this effect.

However, there are also dis-economies related to an effective stabilization policy. In a way, the Swedish authorities in those years carried out a rather clumsy and awkward economic policy. The Government was more or less continuously creating liquidity at a too rapid rate and the Central Bank had, by special restrictive methods, to sterilize most of this liquidity. The type of intensive credit restrictions and regulations that were in force may have had bad effects on the allocation of resources. Strict rationing of resources usually has effects of this nature. The costs of capital - interest rates paid on grey or black credit markets and imputed yields on scarce funds - seem to have had a large dispersion as between firms during these years. Such disparities imply bad functioning of the markets for savings and ineffective allocation of capital resources. Such distortion effects may be rather

of the investment cycle, also ought to have had good results — [illegible] [illegible] available during 1958-59 than if the investments had been made during the boom years of general excess demand. One necessary condition for this relative success with the stabilization policy during these years was of course that the longer-term prospects of industry seemed promising. That was apparently the case. Expanding <u>public works</u> (with large Government [illegible] contributed to this effect.

However, there are also dis-economies related to an effective stabilization policy. In a way, the Swedish authorities in those years carried out a rather clumsy and awkward economic policy. The Government was more or less continuously creating liquidity at a too rapid rate and the Central Bank had, by special restrictive methods, to sterilize most of this liquidity. The type of intensive credit restrictions and regulations that were in force may have had bad effects on the allocation of resources. Strict rationing of resources usually has effects of this nature. The costs of capital - interest rates paid on grey or black credit markets and imputed yields on scarce funds - seem to have had [illegible] Such disparities imply bad functioning of the markets [illegible] savings and ineffective allocation of capital [illegible]sources. Such distortion effects may be rather

insignificant during short periods of restrictive policy - but may be serious over longer periods of repeated manoeuvres of this type. However, we have no possibilities of measuring this kind of productivity-dampening effects.

During the next boom, from the fall of 1959, the restrictive policies were, as mentioned above, quite different. The main difference refers to active and successful attempts to mop up surplus liquidity, in order to create a more general monetary stringency than during the 1950's. The Government carried out extensive open market operations outside the banking system. New taxes (a general purchase tax of 4 per cent was introduced) and more restraint on Government expenditures, resulted in an elimination of the budget deficit. The policy was effective in mopping up surplus liquidity also outside the banking system. The interest rates on treasury bills were raised radically from 1959 to 1960, making it profitable for corporations to shift surplus funds over from bank deposits to treasury bills.

The very restrictive monetary policy that was carried out during the years 1960 and 1961 implied a severe pressure, especially on the commercial banks. They were partly unable to reach the liquidity ratios prescribed, and had during some periods to borrow heavily from the Riksbank. It is remarkable, however, how slow the effects seemed to be on the actual development of bank advances - in contrast to the experiences during the period 1955-57 of drastic credit restrictions.

[illegible] repeated manoeuvres of this type. However, we have no possibilities of measuring this kind of productivity- [illegible]

During the next boom, from the fall of 1959, the restrictive policies were, as mentioned above, quite different. The main difference refers to active and successful attempts to mop up surplus liquidity, in order to create a more general monetary stringency than during [illegible] market operations outside the banking system. New taxes (a general purchase tax of 4 per cent was introduced) and more restraint on Government expenditures, resulted in an elimination of the budget deficit. The policy was effective in mopping up surplus liquidity also outside the banking system. The interest rates on treasury bills were raised radically from 1959 to 1960, making it profitable for corporations to shift surplus funds over from bank deposits to treasury bills.

The very restrictive monetary policy that was carried out during the years 1960 and 1961 implied a severe pressure, especially on the commercial banks. They were partly unable to reach the liquidity ratios prescribed, and had during some periods to borrow heavily from the Riksbank. It is remarkable, however, how slow the effects seemed to be on the actual development of bank advances - in contrast to the experiences [illegible]

There seems to have been no effective dampening of industrial investments; in fact, the volume of investment expenditures in industry expanded by 30 per cent from 1959 to 1961. This result may, however, be taken as partly intended. A high volume of investment in various branches of industry was highly needed in view of the changing structure of production expected to follow the new developments on the Western European markets. Severe restrictions on Government expenditures, and to some extent on private consumption (a general purchase tax), were important complements to the monetary policy during these last years.

5. <u>The Investment Reserve Technique</u>

It should be added to the previous paragraph that a specific Swedish policy invention - the investment fund or reserve method - also had considerable liquidity absorption effects during the years 1960-1961. As this instrument of economic policy may be of special interest, I shall, herein, give a general presentation of its construction.

There are, since a number of years, possibilities for Swedish corporations to make tax-free allocations to so-called investment reserves and to use these reserves during special years of low activity. The purpose is to stabilize investments in building, machinery and inventories over the cycle. During a boom, companies may thus set aside from their profits an investment reserve which is carried in the books on the liabilities' side of the balance sheet, and deducted from the total

There seems to have been no effective dampening of commercial investments. In fact, the volume of investment expenditures in industry expanded by 30 per cent from 1959 to 1961. This result may, however, be taken as partly intended. A high volume of investment in various branches of industry was highly needed in view of the changing structure of production expected to follow the new developments on the Western European markets. Severe restrictions on Government expenditures, and to some extent on private consumption (a general purchase tax), were important complements to the monetary policy during these last years.

5. The Investment Reserve Technique

It should be added to the previous paragraph that a specific Swedish policy invention - the investment fund or reserve method - also had considerable liquidity absorption effects during the years 1960-1961. As this instrument of economic policy may be of special interest I shall, herein, give a general presentation of its construction.

There are, since a number of years, possibilities for Swedish corporations to make tax-free allocations to so-called investment reserves and to use these reserves during special years of low activity. The purpose is to stabilize investments in building, machinery and inventories over the cycle. During a boom, companies may thus set aside from their profits an investment reserve which is carried in the books on the liability side of the balance sheet, and deducted from the total

profits otherwise liable to taxation. When, in some later year, the authorities regard the economic situation as needing some stimulus, these reserves may be released wholly or in part for the immediate writing down of certain types of investment expenditures incurred during the year. Expressed in a very general way, this device means that corporations during boom years with high profits can set aside investment funds (up to a certain per cent of profits) as a writing down of investment expenditures that will be made during later years of low activity, when the National Labour Market Board gives a general or specific allowance. The stimulus to extra high investments (especially in machinery) during boom years with high profits, that the generous depreciations allowance system in Sweden implies, may in this way be effectively reduced. In order to eliminate the liquidity effects of the investment funds that are set aside, a certain part (corresponding to corporation taxes that otherwise had to be paid) has to be deposited, (without interest yield), in the Riksbank. An extra stimulus to use this device is given by a 10 per cent deduction from taxable profits of the investment fund used. The Labour Market Board determines when the investment funds can be used for writing-off purposes and also specifies the conditions, e.g. the period when the investment expenditures should take place. When the funds are used, the deposits at the Riksbank are released to a proportional extent.

The investment fund technique has been applied

[illegible]

be released wholly or in part for the immediate writing down of certain types of investment expenditures incurred during the year. [illegible] device means that corporations during boom years with high profits can set aside investment funds (up to a certain per cent of profits) as a writing down of investment expenditures that will be made during later years of low activity, when the National Labour Market Board gives a general or specific allowance. The stimulus to extra high investments (especially in machinery) during boom years with high profits, that the generous depreciations allowance system in Sweden implies may in this way be effectively reduced. In order to eliminate the liquidity effects of the investment funds that are set aside, a certain part (corresponding to corporation taxes that otherwise had to be paid) has to be deposited, (without interest yield), in the Riksbank. An extra stimulus to use this device is given by a 10 per cent deduction from taxable profits of the investment fund used. The Labour Market Board determines when the investment funds can be used for writing-off purposes and also specifies the conditions, e.g. the period when the investment expenditures should take place. When the funds are used, the deposits at the Riksbank are released to a proportional extent.

[illegible]

with success since 1957. During 1958-59, the Labour Market Board gave allowance to use investment funds set aside during earlier years, in order to stimulate building activity. Funds of considerable size were used during this time. This policy seems to have contributed effectively to the investment boom during the recession. However, there has been some criticism to the effect that the stimulus from the use of investment funds came too late so that the investment boom of 1960 was aggravated. The Labour Market Board has now tried to avoid this difficulty with time lags - that in fact is common to all policy methods - by reacting in an anticipatory way during this current year. Some slack in activity is expected during the winter season 1962-63 and, in May this year, the Board has therefore already announced the possibility of using investment funds during this period.

As mentioned above, the investment fund technique not only means stimulus to investment during recession periods, but should also have a braking effect during booms. This latter effect refers both to postponement of investments and to liquidity absorption. A special method was applied during 1960 and 1961, to stimulate corporations to "sterilize" parts of their liquidity surplus, by making it very profitable for them to deposit 100 per cent of the investment reserve set aside with the Riksbank (and not only the tax equivalent). This possibility was extensively used, thereby aggravating the drain of liquidity from the commercial banks.

[illegible]

activity. Funds of considerable size were used during this time. This policy seems to have contributed effectively to the investment boom during the recession. However, there has been some criticism to the effect that the stimulus from the use of investment funds came too late so that the investment boom of 1960 was aggravated. The Labour Market Board has now tried to avoid this difficulty with time lags - that in fact is common to all policy methods - by reacting in an anticipatory way during this current year. Some slack in activity is expected during the winter season 1962-63 and, in May this year, the Board has therefore already announced the possibility of using investment funds during this period.

As mentioned above, the investment fund technique not only means stimulus to investment during recession periods, but should also have a braking effect during booms. This is [illegible] of investments and to liquidity absorption. A special method was applied during 1960 and 1961, to stimulate corporations to "sterilize" parts of their liquidity surplus, by making it very profitable for them to deposit 100 per cent of the investment reserve set aside with the Riksbank (and not only the tax equivalent). This possibility was extensively used, thereby [illegible] avoiding the drain of liquidity from the commercial banks.

It is of interest to note that the Swedish Government has considerable confidence in the technique of investment reserves as a method of investment stabilization. Earlier - not least in the 1930's - there was much belief in anti-cyclical public works as the main instrument. Experience has shown how difficult it is to build up, renew and use a considerable reserve of public investment projects and get a good timing of expenditures relating to the short recessions that the Swedish economy has so far experienced.

The application of investment taxes and credit rationing - and corresponding releases of these applications - are certainly effective weapons, but tend to work by chock and be disturbing on private enterprise. The system of investment reserve allowances works elastically and rather quickly, because it is built on a basis of voluntary participation of the individual companies and refers to well-prepared projects. That measure just gives a location in time that is desirable from a stabilization point of view. In a way, the system combines the advantages of centralized government planning with decentralized initiative and private knowledge of the merits of each project. The policy certainly involves a considerable element of investment subsidy (in the form of tax allowances) but it is a subsidy given on reliable conditions that the investments will really be made and imply effective incentives for productive developments. In contrast to the various measures of restriction that the Government has been

[illegible]

[illegible] ment reserves as a method of investment stabilization. Earlier - not least in the 1930's - there was much belief in anti-cyclical public works as the main instrument. Experience has shown how difficult it is to build up, renew and use a considerable reserve of public investment projects and get a good timing of expenditures relating to the short recessions that the Swedish economy has so far experienced.

The application of investment taxes and credit rationing - and corresponding releases of these applications - are certainly effective weapons, but tend to work by chock and be disturbing on private enterprise. The system of investment reserve allowances works elastically and rather quickly, because it is built on a basis of voluntary participation of the individual companies and refers to well-prepared projects. That measure just gives a location in time that is desirable from a stabilization point of view. In a way, the system combines the advantages of centralized government planning with decentralized initiative and private knowledge of the merits of each project. The policy certainly involves a considerable element of investment subsidy (in the form of tax allowances) but it is a subsidy given on reliable conditions that the investment will really be made and imply effective incentives for [illegible]

[illegible]

experimenting with during the last decade, the technique of investment reserves is a very popular device among businessmen.

6. Can Swedish policy experiences be useful from Canada's point of view?

It is not possible for me to judge very well to what extent and in what ways the Swedish experiences may be useful from the Canadian point of view. There are always great dangers in transferring experiences from one country to another.

It is clear that in some respects the stabilization policies in Sweden have not been successful. That refers especially to the rapid rise of prices and wages. The monetary policy carried out has been very uneven and experimental. A long period of passivity with a 3-3½ per cent level of long-term interest rates was followed from 1954 by ambitious credit restriction policies under conditions of excess liquidity and scarcity of long-term capital, (with long-term interest rates reaching around 5-6 per cent), after which came the last phase characterized by a remarkable scarcity of liquid funds. Not least, the commercial banks have had great difficulties in adjusting to the rapid shifts in policy. There is no doubt, however, that the restrictive monetary policy measures have had dampening effects on the investment booms - and corresponding stimulus in recessions. On the other hand, we cannot measure, only guess, that this type of policy has had some bad consequences as to the allocation of capital resources and has affected firms and branches of

experimenting with during the last dec[illegible]. The technique of investment reserves is a very popular [illegible]

6. Can Swedish policy experiences be useful from Canada's point of view?

It is not possible for me to judge very well to what extent and in what ways the Swedish experiences may be useful from the Canadian point of view. There are always great dangers in transferring experiences from one country to another.

It is clear that in some respects the stabilization policies in Sweden have not been successful. That refers especially to the rapid rise of prices and wages. The monetary policy carried out has been very uneven and experimental. A long period of passivity with a 3-$3\frac{1}{2}$ per cent level of long-term interest rates [illegible] policies under conditions of excess liquidity and scarcity of long-term capital, (with long-term interest rates reaching around 5-6 per cent), after which came the last phase characterized by a remarkable scarcity of liquid funds. Not least, the commercial banks have had great difficulties in adjusting to the rapid shifts in policy. There is no doubt, however, that the restrictive monetary policy measures have had dampening effects on the investment booms - and corresponding stimulus in recessions. On the other hand, we cannot measure, only guess, that this type of policy has had some bad consequences as to the allocation of capital resources and has affected firms and branches of

activity in a very uneven way.

It is plausible that monetary policy in Sweden has now reached a more balanced stage. There are much better general conditions for effectiveness. The Government budget is in close balance at the same time as the rapidly rising and already large General Pension Fund (a big pension reform was decided in 1960), giving a strong support to a restrictive fiscal policy. The possibilities of self-financing for corporations in private industry has been reduced and will probably continue to be much less than during the 1950's. These factors will imply greater dependence of private firms on the credit market - and will therefore give monetary policy a more strategic position than before. Under these conditions, it may be possible to reach considerable stabilizing effects without the need of the rather drastic measures tested during the past decade. The relatively high level of interest rates reached for long-term Government bonds - as contrasted to the situation at the beginning of the 1950's - is an indication of a realistic adaptation to the underlying scarcity conditions of savings.

It should be added that I have not tried to give a full account of policy instruments in the monetary field. Only the main instruments actually applied have been mentioned. Newly accepted laws for regulation of liquidity and cash reserves, placement quotas and a law for regulating interest

It is plausible that monetary policy in Sweden has now reached a more balanced stage. There are much better general conditions for effectiveness. The Government budget is in close balance at the same time as the rapidly rising and already large General Pension Fund (a big pension reform was decided in 1960), giving a strong support to a restrictive fiscal policy. The possibilities of self-financing for corporations in private industry has been reduced and will probably continue to be much less than during the 1950's. These factors will imply greater dependence of private firms on the credit market - and will therefore give monetary policy a more strategic position than before. Under these conditions it may be possible to reach considerable stabilizing effects without the need of the rather drastic measures tested during the past decade. The relatively high level of interest rates reached for long-term Government bonds - as contrasted to the situation at the beginning of the 1950's - is an indication of a realistic adaptation to the underlying scarcity conditions of savings.

It should be added that I have not tried to give a full account of policy instruments in the monetary field. Only the main instruments actually applied have been mentioned. Newly accepted laws for regulation of liquidity and cash reserves, placement quotas and a law for regulating interest

rates give potential instruments in the hands of the Riksbank, to be used in situations where the more orthodox means seem insufficient to govern the development of the credit and capital markets. As a curiosity - but also as an indication of the "spirit of interference" - I may mention that the law for regulating interest rates contains provision for setting both maximum and minimum rates on bank deposits. The hard competition between the different types of banks for the scarce savings funds tends to take the form of raising the interest rates - and this, especially during times of restrictive monetary policy. The law has never been enforced but is there in the background as a condition for voluntary agreements to prevent an upward slide of interest costs.

There has been relatively good success with policy measures aiming at counteracting recessionary tendencies. In a way, this has been an easier part of policy than the restriction problem during inflationary booms. During the short recessions, originating in demand for exports and disaccummulation of inventories, the expansionary forces of incomes, consumption, government expenditures and parts of fixed investments have been strong - partly being postponement effects from the dampening down of investments during the previous boom. The Government plan of reserving public works for periods of slack activity has played a role but has not been an important factor of stabilization. Yet, the full employment ambitions have reached such

rates give potential instruments in the hands of the Riksbank, to be used in situations where the more [illegible] development of the credit and capital markets. As a curiosity - but also as an indication of the "spirit of interference" - I may mention that the law for regulating interest rates contains provision for setting both maximum and minimum rates on bank deposits. The hard competition between the different types of banks for the scarce savings funds tends to take the form of raising the interest rates - and this, especially during times of restrictive monetary policy. The law has never been enforced but is there in the background as a condition for voluntary agreements to prevent an upward slide of interest costs.

There has been relatively good success with policy measures aiming at counteracting recessionary tendencies. In a way, this has been an easier part of policy than the restriction problem during inflationary [illegible] demand for exports and disaccumulation of inventories, the expansionary forces of incomes, consumption, government expenditures and parts of fixed investments have been strong - partly being postponement effects from the dampening down of investments during the previous boom. The Government plan of reserving public works for periods of slack activity has played a role but has not been an important factor of stabilization. Yet, the full employment ambitions have reached such

high levels in Sweden that there was a fair amount of criticism of the insufficiently expansive and belated policy during the 1958-59 recession (unemployment reaching about 4 per cent). As far as I can see, the stabilization results were not bad: the rate of growth of total production was just retarded to 1 per cent in 1958 in spite of a decline in the volume of exports and a substantial inventory dis-investment.

One good side of the stabilization policies carried out in Sweden during the post-war period has been that it has not resulted in longer periods of retarded growth as in several other countries. It should be remembered, however, that the stabilization policy job has been easier than in countries like Canada, Holland, Denmark and U.K. because of the fact that there has been no exchange difficulties since 1947. This fact in turn can only indirectly and to a limited extent be related to current economic policy. Certainly the devaluation of the Sw. Crown in 1949 (following the English pound) meant a considerable undervaluation that gave sufficient "international space" for a rapid internal expansion.

When looking at Canada's economic problems from the point of view of the Swedish experiences as summarized here, my main impression of difference refers to the slow economic development in Canada since 1956. The policy problems have certainly been very different during this period. In Sweden, the problem has mainly been to prevent total demand (for investment and

high levels in Sweden that there was a fair amount of criticism of the insufficiently expansive and belated policy during the 1958-59 recession (unemployment reaching about 4 per cent). As far as I can see, the stabilization results were not bad: the rate of growth of total production was just retarded to 1 per cent in 1958 in spite of a decline in the volume of exports and a substantial inventory dis-investment.

One good side of the stabilization policies carried out in Sweden during the post-war period has been that it has not resulted in longer periods of retarded growth as in several other countries. It should be remembered, however, that the stabilization policy job has been easier than in countries like Canada, Holland, Denmark and U.K. because of the fact that there has been no exchange difficulties since 1947. This fact in turn can only indirectly and to a limited extent be related to current economic policy. Certainly the devaluation of the Sw. Crown in 1949 (following the English pound) meant a [illegible] gave sufficient "international space" for a rapid [illegible].

When looking at Canada's economic problems from the point of view of the Swedish experiences as summarized here, my main impression of difference refers to the slow economic development in Canada since 1956. The policy problems have certainly been very different during this period. In Sweden, the problem has mainly been to prevent total demand (for investment and

consumption) from expanding too rapidly. For Canada, the problem is rather how to give the economy a stronger push from the demand side. In Sweden, the push on total demand has mainly come from rising exports, fixed investments and Government expenditures - in such proportions, by happy coincidence, that exchange difficulties have been avoided. As a very approximate comparison of the relative strength in these "push factors", I may mention that the sum of exports, fixed investment and Government expenditures, measured in relation to GNP (all in real terms) over the period 1948-60 have been increasing by a little more than 2 per cent per year in Canada and by close to 4 per cent in Sweden. From 1956, the difference in the rate of growth of the push factors (in relation to GNP) is much larger: hardly any increase at all in Canada and 4.3 per cent per year in Sweden. From the point of view of economic policy, I consider this absence of "demand push" during the last period, a central issue in Canada.

In the present stage of the world markets for most of Canadian export goods, with special reference to the sluggishness of the U.S. economy, it is certainly not easy to "arrange" a strong and lasting push on the economy from expanding exports. If - as may be natural from a Swedish point of view - we take rapid growth in national income and productivity and full employment as being of primary importance to the health of the economy, certain risks must be taken with regard to the value of money and the balance of payments situation. From the

[illegible]
the problem is rather how to give the economy a stronger push from the demand side. In Sweden, the push on total demand has mainly come from rising exports, fixed investments and Government expenditures - in such proportions, by happy coincidence, that exchange difficulties have been avoided. As a very approximate comparison of the relative strength in these "push factors", I may mention that the sum of exports, fixed investment and Government expenditures, measured in relation to GNP (all in real terms) over the period 1948-60 have been increasing by a little more than 2 per cent per year in Canada and by close to 4 per cent in Sweden. From 1956, the difference in the rate of growth of the push factors (in relation to GNP) is much larger: hardly any increase at all in Canada and 4.3 per cent per year in Sweden. From the point of view of economic policy, I consider this absence of "demand [illegible]

In the present stage of the world markets for most of Canadian export goods, with special reference to the sluggishness of the U.S. economy, it is certainly not easy to "arrange" a strong and lasting push on the economy from expanding exports. If - as may be natural from a Swedish point of view - we take rapid growth in national income and productivity and full employment as being of primary importance to the health of the economy, certain risks must be taken with regard to the value of money and the balance of payments situation. From the

long-term point of view, a relatively small economy like the Canadian economy, must, if possible, avoid import restrictions and other forms of strong protection. An expansionary policy is not inflationary if the increase of total demand is matched by elastic supply conditions determined by unused capacities of labour and capital. Of course, such a policy would be relatively easy and more or less automatic if there was a simultaneous rapid expansion of the U. S. economy. The difficulties with the Canadian balance of payments, that will arise if this condition should not be fulfilled, may be exaggerated however. Rapid expansion of the Canadian economy - corresponding to the pattern of the post-war years up to 1957 - would imply increasing needs of new investments and therefore high profitability in promising branches of activity. One consequence of this would again be rising influx of U.S. capital in the form of direct investments - perhaps covering the deficit of the current balance of payments that would be due to rising imports of capital goods.

Certainly, this is a very general and perhaps also fairly irresponsible type of policy suggestion coming from a foreigner not knowing much about the political as well as economic possibilities in Canada. Anyhow, quite specific suggestions of policy strategy are necessary in order to make such a general approach to an expansive policy realistic. I can imagine that one necessary condition for giving "international space" (of the Swedish case) to such a

long-term point of view, a relatively small economy like the Canadian economy, must, if possible, avoid import restrictions and other forms of strong protection An expansionary policy is not inflationary if the increase of total demand is matched by elastic supply conditions determined by unused capacities of labour and capital. Of course, such a policy would be relative easy and more or less automatic if there was a simultaneous rapid expansion of the U. S. economy. The difficulties with the Canadian balance of payments, that will arise if this condition should not be fulfilled, may be exaggerated however. Rapid expansion of the Canadian economy - corresponding to the pattern of the post-war years up to 1957 - would imply increasing needs of new investments and therefore high profitability in promising branches of activity. One consequence of this would again be rising influx of U.S. capital in the form of direct investments - perhaps covering the deficit of the current balance of payments that would be due to rising imports of capital goods.

Certainly, this is a very general and perhaps also fairly irresponsible type of policy suggestion coming from a foreigner not knowing much about the political as well as economic possibilities in Canada. Anyhow, quite specific suggestions of policy strategy are necessary in order to make such a general approach to an expansive policy realistic. I can imagine that one necessary condition for giving "international space" (of the Swedish case) to such a

policy might be a further devaluation of the Canadian dollar. Good arguments as to the existence of a potential fundamental dis-equilibrium in the balance of payments at full employment and rapid growth can probably be presented. The rise in the cost of living, following a devaluation, need not be considerable - under the assumption of rapidly rising productivity as a consequence of the expansion of total demand and the prevailing very competitive conditions on the world markets. It was certainly quite another thing to devalue the currencies in 1949 just prior to the Korean inflation.

In waiting for an expansionary boom of Canadian exports, the demand push may have to begin with an expansive fiscal policy, (more rapidly growing Government expenditures at given or lower tax rates). It is easy to say that monetary policy should support an expansive policy of this type, implying that interest rates should be kept as low as the balance of payments restrictions allow. But it is impossible for an outsider to be more specific as to the measures actually needed. It may perhaps be added that if an expansive general policy becomes effective, it may be necessary to shift to a restrictive monetary policy and take account of a potential capital scarcity also in Canada just as in Sweden. This just means that monetary policy has to be flexible with regard to business cycle changes.

It is rather difficult for me to suggest

policy might be a further devaluation of the Canadian dollar. Good arguments as to the existence of a potential fundamental dis-equilibrium in the balance of payments at full employment and rapid growth can probably be presented. The rise in the cost of living, following a devaluation, need not be considerable - under the assumption of rapidly rising productivity as a consequence of the expansion of total demand and the prevailing very competitive conditions on the world markets. It was certainly quite another thing to devalue the currencies in 1949 just prior to the [illegible]

In waiting for an expansionary boom of Canadian exports, the demand push may have to begin with an expansive fiscal policy, (more rapidly growing Government expenditures at given or lower tax rates). It is easy to say that monetary policy should support an expansive policy of this type, implying that interest rates should be kept as low as the balance of payments restrictions allow. But it is impossible for an outsider to be more specific as to the measures actually needed. It may perhaps be added that if an expansive [illegible] to shift to a restrictive monetary policy and take account of a potential capital scarcity also in Canada just as in Sweden. This just means that monetary policy has to be flexible with regard to business cycle changes.

It is rather difficult for me to suggest

how much of Swedish policy instruments in modified editions could be tried in Canada. In a way, lessons from Sweden could only be directly helpful under the condition that Canada reached close to full employment under rapid growth and had to manage recurrent inflationary booms. I imagine that the lessons of rather drastic credit and fiscal restriction measures might then be helpful. The "productivity friendly" type of Swedish investment reserve policy may be something to consider in some revised form, fitting into Canadian taxation conditions. At last, I would especially like to refer to the positive Swedish experiences of an active labour market policy. Rapid expansion of productivity under high and rising employment presumes continuous changes in the economic structure. Factors of production have to shift extensively and smoothly from contracting and stagnating firms and branches of activity to the growth sectors of the economy. High demands are raised not only on the effective functioning of credit and capital markets, but also on the mobility of the labour force. This expression does not only refer to geographical mobility and mobility between branches of industry, but also to mobility between skills. Vocational training schools and programs, within and outside the companies, are expanding very rapidly in Sweden. Growing emphasis is

how much of Swedish policy instruments in modified editions could be tried in Canada. In a way, lessons from Sweden could only be directly helpful under the condition that Canada reached close to full employment under rapid growth and had to manage recurrent inflationary booms. I imagine that the lessons of rather drastic credit and fiscal restriction measures might then be helpful. The "productivity friendly" type of Swedish investment reserve policy may be something to consider in some revised form, fitting into Canadian taxation conditions. At last, I would especially like to refer to the positive Swedish experiences of an active labour market policy. Rapid expansion of productivity under high and rising employment presumes continuous changes in the economic structure. Factors of production have to shift extensively and smoothly from contracting and stagnatin firms and branches of activity to the growth sectors of the economy. High demands are raised not only on the effective functioning of credit and capital markets but also on the mobility of the labour force. This expression does not only refer to geographical mobility and mobility between branches of industry, but also to mobility between skills. Vocational training schools and programs, within and outside the companies, are expanding very rapidly in Sweden. Growing emphasis is

laid on the efficient functioning of the labour market and on the adaptability of labour to changing demands as strategic factors of economic growth.

Stockholm,
August 13, 1962

Erik Lundberg.